SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965

No. 650

JOHN NICHOLAS, TRUSTEE OF THE ESTATE OF BEACHCOMBER MOTEL, INC., BANKRUPT, PETITIONER,

vs.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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[fol. 1]

IN UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF FLORIDA

DEBTOR'S PETITION IN PROCEEDINGS FOR AN ARRANGEMENT UNDER CHAPTER XI—Filed August 6, 1958

In the United States District Court for the Southern District of Florida, Miami Division. In the matter of The Beachcomber Motel, Inc., a Florida corporation, Debtor. No. 3988-M.

To the Honorable Emett C. Choate and Joseph P. Lieb, Judges of the United States District Court for the Southern District of Florida, Miami Division.

The Petition of The Beachcomber Motel, Inc., a Florida corporation, of 18925 Collins Avenue, Miami Beach, in the County of Dade, State of Florida, by occupation a .... [*or* engaged in the business of motel operator] Respectfully Represents:

1. Your petitioner has had his principal place of business [*or* has resided, *or* has had his domicile] at ...., within the above judicial district, for a longer portion of the six months immediately preceding the filing of this petition than in any other judicial district.

2. No bankruptcy proceeding, initiated by a petition by or against your petitioner, is now pending.

3. Your petitioner is insolvent [*or* unable to pay his debts as they mature], and proposes the following arrangement with his *unsecured* creditors: 20% in full; 5% upon confirmation, 5% on January 2, 1959, 5% on February 2, 1959 and 5% on March 2, 1959.

4. The schedule hereto annexed, marked Schedule A, and verified by your petitioner's oath, contains a full and true statement of all his debts, and, so far as it is possible to ascertain, the names and places of residence of his creditors,

and such further statements concerning said debts as are required by the provisions of the Act of Congress relating to bankruptcy.

5. The schedule hereto annexed, marked Schedule B, and verified by your petitioner's oath, contains an accurate inventory of all his property, real and personal, and such further statements concerning said property as are required by the provisions of said Act.

6. The statement hereto annexed, marked Exhibit 1, and verified by your petitioner's oath, contains a full and true statement of all his executory contracts, as required by the provisions of said Act.

7. The statement hereto annexed, marked Exhibit 2, and verified by your petitioner's oath, contains a full and true statement of his affairs, as required by the provisions of said Act.

Wherefore your Petitioner Prays that proceedings may be had upon this petition in accordance with the provisions of chapter XI of the Act of Congress relating to bankruptcy.

The Beachcomber Motel, Inc., a Florida corporation,
By Shirley Woolf, Secretary, Petitioner.

Feibelman & Friedman, Attorneys for Petitioner, 448 Seybold Building, Miami, Fla.

United States of America,
State of Florida,
County of Dade, ss.

I, Shirley Woolf, Secretary of The Beachcomber Motel, Inc., a Florida corporation, the petitioner named in the foregoing petition, do hereby make solemn oath that the statements contained therein are true according to the best of my knowledge, information, and belief.

Shirley Woolf, Petitioner.

Subscribed and sworn to before me this 6th day of August, 1958.

David G. E. Morrison, Notary Public. Notary Public, State of Florida at Large. My Commission expires March 10, 1959. Bonded by American Surety Co. of N. Y.

[File endorsement omitted]

Oaths required by this act, except upon hearings before a judge, may be administered by referees and by officers authorized to administer oaths in proceedings before the courts of the United States, or under the laws of the State where the same are to be taken; and diplomatic or consular officers of the United States in any foreign country.

All petitions and schedules shall be printed or written out plainly, without abbreviation or interlineation, except where such abbreviation and interlineation may be for the purposes of reference. (Rule 5 Paragraph 1).

The court may allow amendments to the petition and schedules on application of the petitioner. Amendments shall be printed or written, signed and verified, like original petitions and schedules, and filed in triplicate. If amendments are made to separate schedules, the same must be made separately, with proper references. In the application for leave to amend, the petitioner shall state the cause of the error in the paper originally filed. (Rule 11.)

[fol. 2]

SCHEDULE A—STATEMENT OF ALL DEBTS OF BANKRUPTCY

(See opposite) ☞

Schedule A—STATEMENT OF ALL DEBTS OF BANKRUPT.

Schedule A-1. Statement of all creditors to Whom Priority is Secured by the Act.

Claims which have priority.	Reference to ledger or voucher	Names of creditors.	Residences (if unknown, that fact must be stated).	When and where incurred or contracted.	Whether claim is contingent, unliquidated or disputed.	Nature and consideration of the debt, and whether incurred or contracted as partner or joint contractor and, if so, with whom.	Amount due or claimed. $	Cts.
a								
Wages due workmen, servants, clerks, or travelling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt, to an amount not exceeding $600 each, earned within three months before filing the petition.	None.							
b								
Taxes due and owing to—								
(1) The United States:		Director of Internal Revenue, Jacksonville, Florida - F.U.T.A. and S.S. Tax					9,684	09
(2) The State of								
(3) The county, district or municipality of State of		Ray E. Green, Comptroller, Tallahassee, Florida					1,766	77
c								
(1) Debts owing to any person, including the United States who by the laws of the United States is entitled to priority.								
(2) Rent owing to a landlord who is entitled to priority by the laws of the State of , accrued within three months before filing the petition, for actual use and occupancy.		Raymond Wennick, as Trustee, c/o Daniel Sepler Citizens Federal Savings Hialeah, Florida Under lease of June 18, 1957					15,000	00

b Taxes due and owing to—		
(1) The United States:	Director of Internal Revenue, Jacksonville, Florida - F.U.T.A. and S.S. Tax	9,684.09
(2) The State of	Ray E. Green, Comptroller, Tallahassee, Florida	1,766.77
(3) The county, district or municipality of State of		
c (1) Debts owing to any person, including the United States who by the laws of the United States is entitled to priority.		
(2) Rent owing to a landlord who is entitled to priority by the laws of the State of , accrued within three months before filing the petition, for actual use and occupancy.	Raymond Wennick, as Trustee, c/o Daniel Sepler Citizens Federal Savings Hialeah, Florida Under lease of June 18, 1957	15,000.00
	Total	26,450.86

THE BEACHCOMBER MOTEL, INC.

By _____

SHIRLEY WOOLF, Secretary Petitioner.

Schedule A-1. Statement of all creditors to whom priority is secured.

SUMMARY OF DEBTS AND ASSETS.

[From the statements of the debtor in Schedules A and B.]

Schedule A—	1-a	Wages			
Schedule A—	1-b (1)	Taxes due United States	9,684	.09	
Schedule A—	1-b (2)	Taxes due States	1,766	.77	
Schedule A—	1-b (3)	Taxes due counties, districts and municipalities			
Schedule A—	1-c (1)	Debts due any person, including the United States, having priority by laws of the United States			
Schedule A—	1-c (2)	Rent having priority	15,000	.00	
Schedule A—	2	Secured claims	25,000	.00	
Schedule A—	3	Unsecured claims	81,949	.16	
Schedule A—	4	Notes and bills which ought to be paid by other parties thereto			
Schedule A—	5	Accommodation paper			
		Schedule A, Total	133,400	.02	
Schedule B—	1	Real Estate			
Schedule B—	2-a	Cash on hand	500	.00	
Schedule B—	2-b	Negotiable and non-negotiable instruments and securities			
Schedule B—	2-c	Stock in trade	981	.00	
Schedule B—	2-d	Household goods			
Schedule B—	2-e	Books, prints, and pictures			
Schedule B—	2-f	Horses, cows, and other animals			
Schedule B—	2-g	Automobiles and other vehicles			
Schedule B—	2-h	Farming stock and implements			
Schedule B—	2-i	Shipping and shares in vessels			
Schedule B—	2-j	Machinery, fixtures, and tools	28,000	.00	
Schedule B—	2-k	Patents, copyrights, and trade-marks			
Schedule B—	2-l	Other personal property	10,914	.60	
Schedule B—	3-a	Debts due on open accounts	7,100	.00	
Schedule B—	3-b	Policies of insurance			
Schedule B—	3-c	Unliquidated claims			
Schedule B—	3-d	Deposits of money in banks and elsewhere	1,940	.00	

Schedule A—	1-c (2)	Rent having priority		15,000.00	
Schedule A—	2	Secured claims		25,000.00	
Schedule A—	3	Unsecured claims		81,949.16	
Schedule A—	4	Notes and bills which ought to be paid by other parties thereto			
Schedule A—	5	Accommodation paper			
		Schedule A, Total		133,400.02	
Schedule B—	1	Real Estate			
Schedule B—	2-a	Cash on hand		500.00	
Schedule B—	2-b	Negotiable and non-negotiable instruments and securities			
Schedule B—	2-c	Stock in trade		981.00	
Schedule B—	2-d	Household goods			
Schedule B—	2-e	Books, prints, and pictures			
Schedule B—	2-f	Horses, cows, and other animals			
Schedule B—	2-g	Automobiles and other vehicles			
Schedule B—	2-h	Farming stock and implements			
Schedule B—	2-i	Shipping and shares in vessels			
Schedule B—	2-j	Machinery, fixtures, and tools		28,000.00	
Schedule B—	2-k	Patents, copyrights, and trade-marks			
Schedule B—	2-l	Other personal property		10,914.60	
Schedule B—	3-a	Debts due on open accounts		7,100.00	
Schedule B—	3-b	Policies of insurance			
Schedule B—	3-c	Unliquidated claims			
Schedule B—	3-d	Deposits of money in banks and elsewhere		1,940.00	
Schedule B—	4	Property in reversion, remainder, expectancy or trust			
Schedule B—	5	Property claimed as exempt	$		
Schedule B—	6	Books, deeds and papers			
		Schedule B, Total		49,435.60	

Summary of Debts and Assets.

THE BEACHCOMBER MOTEL, INC.

By _____
SHIRLEY WOOLF, Secretary Petitioner

[fol. 3]

[fol. 9]

IN UNITED STATES DISTRICT COURT

MOTION FOR ADJUDICATION AND MOTION FOR A RECEIVER—
Filed September 12, 1958

Comes now your petitioner, Dade County Dairies, Inc., by and through its undersigned attorney and shows unto this Court as follows:

1. That it is a creditor of the above and foregoing Debtor in the amount of Seven Hundred Ninety-Six Dollars and Eighty-nine Cents ($796.89) for merchandise sold and delivered.

2. That it holds no security for its indebtedness, nor has it received any preferential payment.

3. That the premises of the Beachcomber Motel have now been closed, and no Plan of Arrangement can be effected, and that the assets of this estate are imperilled and the rights of the creditors of this estate in the said assets are in peril because of the lack of supervision and control by any court officer over the aforementioned Beachcomber Motel.

Wherefore, your petitioner prays as follows:

1. That this Court enter its Order adjudicating the Debtor a bankrupt.

[fol. 10] 2. That this Court enter its Order appointing a Receiver to take charge of the assets of this estate.

John H. Gunn, Attorney for Dade County Dairies, Inc., petitioner, 1205 Biscayne Building, Miami 32, Florida.

[File endorsement omitted]

Duly sworn to by John H. Gunn, jurat omitted in printing.

Certificate of Service (omitted in printing).

[fol. 11]

IN UNITED STATES DISTRICT COURT

ADJUDICATION OF BANKRUPTCY—September 17, 1958

At Miami, in said District, on the 17th day of September, 1958.

The petition of The Beachcomber Motel, Inc. filed on the 17th day of September, 1958, that it be adjudged a bankrupt under the Act of Congress relating to bankruptcy, having been heard and duly considered; and there being no opposing interest;

It is adjudged that the said The Beachcomber Motel, Inc. is a bankrupt under the Act of Congress relating to bankruptcy.

L. Earl Curry, Referee in Bankruptcy.

[File endorsement omitted]

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

PROOF OF CLAIM FOR INTERNAL REVENUE TAXES—
Filed April 11, 1963

IN THE MATTER OF:

• THE BEACHCOMBER MOTEL, INC.,
a Florida corporation,

Bankrupt.

DOCKET NO. 3988-M

TYPE OF PROCEEDING LIQUIDATING BANKRUPTCY
(Ori. Pet. filed in Arrangement, Ch. XI 8-6-58)

CLAIM OF THE UNITED STATES

FOR INTERNAL REVENUE TAXES

TO CONSOLIDATE AND SUPERSEDE ALL PRIOR PROOFS OF CLAIM AND ADMINISTRATIVE EXPENSE STATEMENT OF TAXES DUE.

The undersigned officer of the Internal Revenue Service, a duly authorized agent of the United States in this behalf, being duly sworn, deposes and says that:

1. The Beachcomber Motel, Inc., is justly and truly indebted to the United States in the sum of $3,037.35 with interest thereon as hereinafter stated;

2. The said debt is for taxes due under the internal revenue laws of the United States as follows:

KIND OF TAX AND PERIOD	REFERENCE NO.	AMOUNT DUE	REMARKS	DATE TAX LIEN AROSE
W-FICA, Qtr. 9/58	(59-4-14-Spl #11-02)	Bal. $ 60.04		4-14-59
Excise, Qtr. 9/58	(59-4-14-Spl #2-00)	644.00		4-14-59

FILED

CLAIM OF THE UNITED STATES

FOR INTERNAL REVENUE TAXES

Bankrupt.

TO CONSOLIDATE AND SUPERSEDE ALL PRIOR PROOFS OF CLAIM AND ADMINISTRATIVE EXPENSE STATEMENT OF TAXES DUE.

The undersigned officer of the Internal Revenue Service, a duly authorized agent of the United States in this behalf, being duly sworn, deposes and says that:

1. The Beachcomber Motel, Inc., is justly and truly indebted to the United States in the sum of $3,037.35 with interest thereon as hereinafter stated;

2. The said debt is for taxes due under the internal revenue laws of the United States as follows:

KIND OF TAX AND PERIOD	REFERENCE NO.	AMOUNT DUE	REMARKS	DATE TAX LIEN AROSE
W-FICA, Qtr. 9/58	(59-4-14-Spl #11-02)	Bal. $ 60.04		4-14-59
Excise, Qtr. 9/58	(59-4-14-Spl #2-00)	644.00		4-14-59
TOTAL PRE-PETITION TAXES.....		$704.04		
Administrative Expense Taxes:				
W-FICA, Qtr. A-9/58	(62-2-2-165018).....	519.89*		2--2-62
Assessed Penalty.....		129.97*		
Assessed Interest.....		101.54		
Accrued Interest to 4-10-63.....		46.34		
Excise, Qtr. 9/58	(59-4-14 Spl #2-00)..	644.00*		4-14-59
Assessed Penalty.....		161.00*		
Assessed Interest.....		17.58		
Accrued Interest to 4-10-63.....		192.35		
FUTA, 1958	(59-4-14-Spl #5-00)..	362.29*		4-14-59
Assessed Penalty.....		54.34*		
Assessed Interest.....		4.46		
Accrued Interest to 4-10-63.....		99.55		
TOTAL POST-PETITION TAXES..		$2,333.31		

GRAND TOTAL PRE-PSTITION AND POST PETITION TAXES $3,037.35

(FILE EXHIBIT OMITTED)

[fol. 13]

*Plus interest on this amount at 6% per annum or at the rate of $0.31 per day from 4/11/63 to date of payment.

3. No part of said debt has been paid and the same is now due and payable at the Office of the District Director of Internal Revenue;
4. There are no set-offs or counterclaims to said debt;
5. Except for the statutory tax liens which arose on the dates above stated, the United States does not hold, to the deponent's knowledge or belief, any security or securities for said debt;
6. No note or other negotiable instrument has been received for said debt or any part thereof, nor has any judgment been rendered with respect to said debt; and
7. Said debt has priority and must be paid in full in advance of distribution to creditors as and to the extent provided by law:

IN BANKRUPTCY ACT PROCEEDINGS see Sections 64, 77e, 199, 337(2), 455, and 659 of the Bankruptcy Act (11 U.S.C. 104, 205(e), 599, 737(2), 855, and 1059).

IN OTHER PROCEEDINGS see Section 3466 of the Revised Statutes (31 U.S.C. 191). Also, attention is invited to Section 3467 (31 U.S.C. 192) with respect to the personal liability of any executor, administrator, or other person who fails to pay the claims of the United States in accordance with their priority.

SUBSCRIBED AND SWORN TO BEFORE ME THIS

10th day of April 1963

Jurat omitted under Section 57a of the Bankruptcy Act as amended by Public Law 86-519 dated 6-12-60.

SIGNATURE Jack Durant

JACK DURANT

TITLE CHIEF, SPECIAL PROCEDURES SECTION

Office of the District Director of Internal Revenue

ADDRESS 400 West Ashley Street
P. O. Box 4249
Jacksonville, Florida

PART 1—FOR COURT (Or Fiduciary, if required by local procedures)

FORM 2317 (REV. 9-61)

3988 51

6

[fol. 13]

[File endorsement omitted]

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

PROOF OF CLAIM FOR INTERNAL REVENUE TAXES—
Filed April 11, 1963

[fol. 15]

IN THE UNITED STATES DISTRICT COURT

TRUSTEE'S OBJECTIONS TO CLAIMS—
Filed September 24, 1963

Comes Now, John Nicholas, Trustee of the estate of the above styled Bankrupt, and files the following objections to claims filed herein:

1. Objection to claim #1 filed by Mr. Foster's Store in the amount of $206.73, which claimant claims priority, on the ground that there is no basis in law for according priority status to said claim.

2. Objection to claim #12 filed by Gerard B. Nolan in the amount of $500.00 for wages for the month of July 1958 on the ground that there is no proof in or annexed to said claim as to the alleged employment of the claimant, the dates and nature of the employment for which the claim is filed and accordingly no basis in law for according priority status to said claim.

3. Objection to claim #13 filed by Fines C. Nolan in the amount of $132.90 for alleged wages for the period from July 16th to August 1st, 1958, inasmuch as there is no proof in or annexed to said claim as to the alleged employment of the claimant, the dates and nature of employment for which the claim is filed and accordingly no basis in law for according priority status to said claim.

4. Objection to claim #22 filed by National Cash Register Company in the amount of $3,325.00 as an al-
[fol. 16] leged "secured" claim so as to deny priority status to said claim.

5. Objection to claim #29 filed by Airko Air Conditioning Co. in the amount of $1,012.51, which claimant claims priority status, said claim being for maintenance service, on the ground that there is no basis in law for according said claim priority status.

6. Objection to claim #38 filed by Mitchell S. Gordon in the amount of $70.00 as entertainer for which claim priority is claimed, on the ground that there is no basis in law for according said claim priority status.

7. Objection to claim #40 filed by Radio Corporation of America in the amount of $453.88 allegedly representing the unpaid balance under a retain title contract, so as to deny said claim "priority" status.

8. Objection to claim #51 filed by Internal Revenue Service in the amount of $3,037.35 so as to strike therefrom and reduce said claim by the amounts therein claimed and set forth as alleged penalties and post petition interest, and so as to limit the interest claimed thereunder to August 6th, 1958 the date of the filing of the Petition herein.

9. Objection is made to and motion is hereby made to strike claims #4, 42, 43 and 46 filed by Internal Revenue Service on the ground that claim #51 filed by Internal Revenue Service supersedes all prior claims filed by Internal Revenue Service.

John Nicholas, Trustee in Bankruptcy.

[fol. 17] John H. Gunn, Attorney for Trustee, 1534 Alfred I. duPont Building, Miami 32, Florida, By Irving M. Hartman.

[File endorsement omitted]

Duly sworn to by John Nicholas, jurat omitted in printing.

Certificate of Service (omitted in printing).

[fol. 19]

IN THE UNITED STATES DISTRICT COURT

ORDER ON TRUSTEE'S OBJECTIONS TO CLAIMS—
December 11, 1963

This Cause having come on before the Court on the Trustee's Objections to Claims filed herein, and after hearing Counsel for the Trustee, and Counsel for the Internal Revenue Service, and Mitchell S. Gordon, Claimant in person, and upon examination of the Claims filed herein, with such supporting documents as are annexed thereto, and the Court being otherwise fully advised in the premises, it is hereby,

Ordered:

1. That Claim No. 1 filed by Mr. Foster's Store in the amount of $206.73 be and the same is hereby allowed as an unsecured claim, without priority status.

2. That the Objection filed to Claim No. 12 be and the same is hereby disallowed, and said claim filed by Gerard B. Nolan in the amount of $500.00 for wages for the month of July, 1958, be and the same is hereby allowed as a priority claim, entitled to a second priority.

3. That the Objection filed to Claim No. 13 be, and the same is hereby disallowed and said claim filed by Fines [fol. 20] C. Nolan in the amount of $132.90 for wages for the period from July 16th to August 1, 1958, be and the same is hereby allowed as a priority claim, entitled to a second priority.

4. That the Objection filed to Claim No. 22 of National Cash Register Company in the amount of $3,325.00 as an alleged "Secured" and "Priority" claim be and the same is hereby sustained, and said claim be and the same is hereby allowed as an unsecured claim, without priority status.

5. That the Objection filed to Claim No. 29 filed by Airco Air Conditioning Co. in the amount of $1,012.51 as a Priority Claim be and the same is hereby sustained and said claim be and the same is hereby allowed as an unsecured claim, without priority status.

6. That the Objection filed to Claim No. 38 of Mitchell S. Gordon in the amount of $70.00 as an entertainer as an alleged wage claim be and the same is hereby sustained and said claim be and the same is hereby allowed as an unsecured claim, without priority status.

7. That the Objection filed to Claim No. 40 filed by Radio Corporation of America in the amount of $453.88 as an alleged priority claim be and the same is hereby sustained, and said claim be and the same is hereby allowed as an unsecured claim, without priority status.

8. That the Objection filed to Claim No. 51 of Internal Revenue Service in the amount of $3,037.35 be and the [fol. 21] same is hereby sustained, and the three items included therein entitled "Assessed Penalty" in the amounts of $129.97, $161.00 and $54.34, together with the three items entitled "Accrued Interest to 4/10/63" in the amounts of $46.34, $192.35, and $99.55, be and they are hereby disallowed and stricken from said claim, and said claim be and the same is hereby allowed to the following extent: (1) as an Administrative Tax Claim in the amount of $1,649.76 entitled to a first priority; and (2) as a Tax Claim in the amount of $683.55, entitled to a fourth priority.

9. That Claims No. 4, 42, 43 and 46 filed by Internal Revenue Service, having been consolidated into Claim No. 51, aforesaid, and being duplicated therein, be and the same are hereby disallowed and stricken.

Done and Ordered at Miami in said District, this 11 day of Dec., 1963.

J. B. Booher, Referee in Bankruptcy.

[File endorsement omitted]

IN UNITED STATES DISTRICT COURT

PETITION FOR REVIEW—Filed December 19, 1963

Comes now the United States of America, by and through its undersigned Attorney, and moves this Honorable Court [fol. 22] to review the Order of J. B. Booher, Referee in Bankruptcy, dated the 11th day of December 1963, disallowing certain portions of the Government's tax claims and determining the priority of other portions of said claims, and as reason therefor says that such determinations are contrary to law.

Dated at Miami, Florida, this 19th day of December 1963.

William A. Meadows, Jr., United States Attorney,
By: Lavinia L. Redd, Assistant United States Attorney.

[File endorsement omitted]

Certificate of Service (omitted in printing).

[fol. 24]

IN UNITED STATES DISTRICT COURT

CERTIFICATE OF REVIEW—Filed February 5, 1964

To the Honorable Judges of the Above Styled Court, Sitting in Review:

I, J. B. Booher, Referee in Bankruptcy herein, on the Petition of United States of America to review an Order made by me dated the 11th day of December, 1963, disallowing certain portions of the Government's tax claims, and determining the priority of other portions of said claims, hereby certify as follows:

1. Petition for an Arrangement under Chapter XI of the Acts of Congress relating to Bankruptcy filed on August 6, 1958, as Court File Paper 1.

2. Petition of Creditor for Order of Adjudication and appointment of Receiver filed September 12, 1958, as Court File Paper 13.

3. Order of Adjudication, filed on September 17, 1958, as Court File Paper 16.

4. Proofs of Claim filed by the United States of America on September 4, 1958, April 16, 1959, and June 15, 1959, as Claims number 4, 42, 43 and 46.

5. Proof of Claim and administrative expense statement filed by the United States of America consolidating and superseding all prior claims, filed on April 11, 1963, as Claim number 51.

6. Trustee's objections to claims, including motion to strike Claims 4, 42, 43 and 46 and objection to Claim No. [fol. 25] 51 filed by Internal Revenue Service, filed on September 24, 1963, as Court File Paper 188.

7. Order on Trustee's Objections to Claims filed on December 11, 1963, as Court File Paper 192.

8. Petition for Review of United States of America filed on December 19, 1963, as Court File Paper 193.

9. This Certificate on Petition for Review.

10. The questions presented are the alleged errors set forth in said Petition for Review dated the 19th day of December, 1963.

Dated February 5, 1964.

Respectfully submitted,

J. B. Booher, Referee in Bankruptcy.

[File endorsement omitted]

IN THE UNITED STATES DISTRICT COURT

ORDER AFFIRMING ORDER OF REFEREE—
April 6, 1964

This Cause came on to be heard on the Petition for Review filed herein by the United States of America, where- [fol. 26] in it sought to review an order entered by J. B. Booher, Referee in Bankruptcy, dated the 11th day of December, 1963, insofar as said order disallowed certain portions of the Government's tax claim and determined the priority of other portions of said claim, and on the Certificate of Review of said Referee dated the 5th day of February, 1964, filed herein by said Referee, and after hearing argument of counsel for the Trustee and of counsel for the United States of America, and the Court being otherwise fully advised, it is hereby

Ordered that the said Order entered herein on the 11th day of December, 1963, by Honorable J. B. Booher, Referee in Bankruptcy, be and the same is hereby affirmed.

Done and Ordered at the Courthouse in said District at Miami, Florida, this 6 day of April, 1964.

Emett C. Choate, United States District Judge.

Filed Miami, Florida, April 14, 1964. J. B. Booher, Referee in Bankruptcy.

[File endorsement omitted]

[fol. 27]

IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed May 5, 1964

Comes now the United States of America and appeals the Order of the Court, affirming the Order of the Referee, dated April 6, 1964.

William A. Meadows, Jr., United States Attorney,
By: Lavinia L. Redd, Assistant United States Attorney.

[File endorsement omitted]

IN UNITED STATES DISTRICT COURT

TRUSTEE'S INTERIM REPORT—Filed July 5, 1961

To the Honorable J. B. Booher, Referee in Bankruptcy:

Comes now John Nicholas, Trustee herein, and respectfully shows unto this Court.

1. That he is the duly appointed and qualified Trustee herein.

[fol. 28] 2. That the following statement attached hereto, of his receipts and disbursements and his balance on hand, and the present status of the case, which he certified to be a true and correct accounting of his trust to date.

John Nicholas, Trustee.

State of Florida,
County of Dade, ss.

Before me the undersigned authority, personally appeared John Nicholas, who, being by me first duly sworn, deposes and says that he has read the above and foregoing report and that the facts therein are true and correct to the best of his knowledge and belief.

John Nicholas.

Sworn to and Subscribed before me this 5th day of July, 1961. Jeanette E. Tavormina, Notary Public, State of Florida at Large. My Commission Expires Jan. 5, 1963. Bonded by American Surety Co. of N. Y.

[File endorsement omitted]

Trustee's Interim Report, Beachcomber Motel, Inc., No. 3988-M.

RECEIPTS:		
Turnover—Settlement Bell Paper		$ 750.00
Turnover—Refund Horsley Millard Insurance Co.		1,018.48
[fol. 29]		
Judgment—Florida Power and Light		3,072.87
Suit—Settlement So. Bell Telephone		1,519.27
Turnover—Sale of inventory—18925 Collins Avenue Corp.		2,000.00
Turnover order—Mercantile National Bank		1,806.27
Settlement—Shirley Woolf		2,500.00
Total receipts		$ 12,666.89
DISBURSEMENTS:		
Court reporter	$ 735.10	
Photostats	25.76	
Filing fee—Clerk of USDC	58.90	
Abraham H. Shukat, attorneys fee—per C. O.	2,500.00	
Nathan Newman—Accountants fee per C. O.	450.00	
Appraisers	30.00	
Docket fee—Clerk of USCA	25.00	3,824.76
BALANCE ON HAND AS OF JULY 5, 1961		$ 8,842.13

NOTE:
Suit filed May 31, 1961, by creditors against the landlord of bankrupt to recover the security deposit under the bankrupts lease.

EXHIBIT A

[fol. 30]

IN UNITED STATES DISTRICT COURT

DESIGNATION OF RECORD FOR PRINTING—
Filed August 6, 1964

U. S. Court of Appeals, Edward W. Wadsworth, Clerk.

Comes now the United States of America, Appellant herein, and designates for printing the following portions of the Record on Appeal:

1. Petition for an Arrangement under Chapter XI of the Acts of Congress relating to Bankruptcy filed on August 6, 1958, (Court File Paper 1).

2. Petition of Creditor for Order of Adjudication and appointment of Receiver filed September 12, 1958, (Court File Paper 13).

3. Order of Adjudication, filed on September 17, 1958, (Court File Paper 16).

4. Proof of Claim and administrative expense statement filed by the United States of America consolidating and superseding all prior claims, filed on April 11, 1963, as Claim number 51.

5. Trustee's objections to claims, including motion to strike Claims 4, 42, 43 and 46 and objection to Claim No. [fol. 31] 51 filed by Internal Revenue Service, filed on September 24, 1963 (Court File Paper 188).

6. Order on Trustee's Objections to Claims filed on December 11, 1963, (Court File Paper 192).

7. Petition for Review of United States of America filed on December 19, 1963, (Court File Paper 193).

8. Certificate on Petition for Review filed February 5th, 1964.

9. Order Affirming Order of Referee, dated April 6, 1964.

10. Notice of Appeal filed May 5th, 1964.

11. Trustee's Interim Report, dated and filed July 5th, 1961 and Exhibit A thereof, (Court File Paper 163).

William A. Meadows, Jr., United States Attorney,
By: Lavinia L. Redd, Assistant U. S. Attorney.

Certificate of Service (omitted in printing).

[fol. 32]

IN UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 21777

UNITED STATES OF AMERICA,

versus

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt.

ARGUMENT AND SUBMISSION—April 27, 1965

On this day this cause was called, and after argument by Karl Schmeidler, Esq., Atty., Dept. of Justice, for Appellant, and Robert E. Venney, Esq., for appellee, was submitted to the Court.

[fol. 33]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 21777

UNITED STATES OF AMERICA, Appellant,

versus

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA

OPINION—May 25, 1965

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

TUTTLE, Chief Judge: On August 6, 1958, Beachcomber Motel, Inc., filed a petition for an arrangement proceeding under Chapter XI of the Bankruptcy Act. It was permitted to retain possession of the property as Debtor in Possession until, upon failure to submit an acceptable plan, [fol. 34] the company was adjudicated a bankrupt on September 17, 1958. During the intervening period of operation, the Debtor in Possession failed to make payment of certain taxes that accrued during this short period of operation. In fact, under the statute, the taxes that were collected or withheld for the quarter ending September 30, 1958, were not required to be included in returns to be filed until October 31, 1958. Others were to be returned by January 31, 1959. By this time, of course, the Trustee in Bankruptcy had succeeded to the duties of the former Debtor in Possession.

The Trustee failed to make the required returns and the Government filed an administrative expense statement

of the taxes due covering the following amounts: $519.89 of withholding and FICA taxes (Federal Insurance Contributions Act) accruing between August 6, 1958, when the petition for arrangement was filed and September 17, 1958, when the taxpayer was adjudicated a bankrupt; $644 of cabaret excise taxes also accruing between the same dates, and $362.29 of FUTA (Federal Unemployment Tax Act) accruing during 1958. The aggregate of these items is $1,526.18.

Additionally, the United States stated as administrative expense assessed interest on each of the three principal items above set forth in the amounts of $101.54, $17.58, and $4.46, respectively, totalling $123.58. These two sums, $1,526.18 principal amount of tax and assessed interest of $123.58, totalling $1,649.76, were allowed by the referee as an administrative tax claim entitled to first priority. [fol. 35] However, the referee sustained the trustee's objection to the Government's claim No. 51 as to the amounts set forth as alleged penalties and accrued interest. Thus, the referee disallowed the following amounts contained in the Government's administrative expense statement of taxes due; namely, assessed penalty on the withholding and FICA taxes in the amount of $129.97, on the excise taxes in the amount of $161, and on the FUTA in the amount of $54.34, aggregating $345.31. The referee also disallowed interest after the date of the assessment and accrued to April 10, 1963 (the day before the date of filing of Claim No. 51) on the withholding and FICA taxes in the sum of $46.34, on the amount of excise taxes in the sum of $192.35, and on the amount of FUTA taxes in the sum of $99.55, totalling $338.24. Claim No. 51 also sought interest on the amounts due at the rate of 31 cents per day from April 11, 1963, the date of the filing of the claim.

The referee, as already stated, allowed as an administrative expense entitled to a first priority the principal amounts of the taxes and assessed interest. Thus, the only controversy here is with respect to his disallowance

of the items of assessed penalties totalling $345.31 and interest accrued after the date of assessment, totalling $338.24, in all, $683.55 together with interest from April 11, 1963.

Upon a petition for review filed by the United States from the disallowance of these penalties and interest, the District Court affirmed the order of the referee.

As the Government points out, the distinction between taxes which accrue against a taxpayer prior to bankruptcy [fol. 36] and those which accrue against a trustee after bankruptcy, has become well settled. Pre-bankruptcy taxes are payable as tax claims against the bankrupt's estate under §57 of the Bankruptcy Act. 11 U.S.C.A. §93. They are entitled to payment as of the Fourth priority under §64a of the Act, 11 U.S.C.A. §104. If, however, a trustee becomes subject to taxes as a result of operations carried on after bankruptcy, these taxes constitute an expense of administration under §62a of the Act and, as such, are payable as a First priority under §64a.

The duty of the trustee in bankruptcy to pay taxes which accrue during the course of his administration, independent of tax claims which had accrued prior to bankruptcy, has long been recognized by the Supreme Court. See *Michigan* v. *Michigan Trust Co.*, 286 U.S. 334. Here, of course, the referee recognized this obligation, and properly required the payment of the principal amount of the taxes as an expense of administration. He drew the line, however, at the payment of interest on this principal amount of the taxes and additions to the tax, commonly called a penalty, arising from the failure of the trustee to make the necessary returns and payments on time.

The trustee here contends that since the taxes accrued while the Debtor in Possession was operating the corporation later to become bankrupt, rather than the trustee after bankruptcy, the taxes that accrued during this period should be treated as pre-bankruptcy taxes as should also, of course, the interest and penalties, if they are payable at all, when the failure to make the proper returns

[fol. 37] and payments is a failure of the bankruptcy trustee. As the Government points out, however, when a debtor is permitted to retain his possession under a Chapter XI arrangement proceeding, he is, within contemplation of the law, just like a trustee, certainly to the extent of his obligation and duty to do the things that the statute would require of a trustee in possession. In fact, where a plan for arrangement turns out to be unsuccessful and an adjudication of bankruptcy is entered, §3782 of the Act provides that "the proceedings shall be conducted, so far as possible, in the same manner and with like effect, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this Chapter was filed; . . . " 11 U.S.C. §778. See *United States* v. *Sampsell,* 9 Cir., 193 F.2d 154. See also 8 Coll. on Bankruptcy (14 Ed. 1963 Rev.) Secs. 6.31 and 6.32 which states "the general purpose of §342 is that where a debtor continues in possession of his property, he shall be in fact a trustee. 'Its position as debtor, continued in possession, is for all practical purposes that of a trustee or receiver . . . ' 'A debtor continued in possession by court order is a court officer analogous to a receiver or trustee.' A debtor in possession 'has all the powers of an ordinary trustee . . . ' "

Thus, it is plain that the obligation of the trustee here was the same as if he had been in possession from the filing of the original Section XI proceedings. This being the case, it appears that the leading decision *Boteler* v. *Ingels,* 308 U.S. 57, answers the basic question whether the trustee is liable to the same obligation to make required [fol. 38] returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face. We think it clear that he is so subject. The Supreme Court said in that case, "if businesses in California not conducted by a bankruptcy trustee are delinquent in the fees, they must pay the penalty. However, petitioners contention would exempt a trustee operating a business in bankruptcy

from this double-tax liability which other delinquents must bear. A state would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment." (p. 61)

We conclude that the principle announced in the *Boteler* case clearly applies here to the federal impositions. Thus, it follows that the referee and the trial court erred in not including the items listed above as costs and expenses of administration and thus payable under the First priority.

The judgment is Reversed and the case is Remanded for further proceedings not inconsistent with this opinion.

[fol. 39]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

October Term, 1964

No. 21777

D. C. Docket No. 3988-M-Bankruptcy U. S. Civil

UNITED STATES OF AMERICA, Appellant,

versus

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

JUDGMENT—May 25, 1965

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by Counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

Issued as Mandate: May 25, 1965.

[fol. 40]

[File endorsement omitted]

[fol. 42]

IN THE UNITED STATES COURT OF APPEALS

[Title omitted]

PETITION FOR REHEARING—Filed June 23, 1965

The Appellee, John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, for petition for rehearing from the Opinion of the Court rendered May 25, 1965, in the above cause, says:

1. The Court has failed to recognize that the Internal Revenue Code requires tax returns to be made by those persons collecting and receiving revenue and the Court's Opinion is an extension of existing legislation to bankruptcy trustees and reaches a result neither contemplated nor intended by the Federal Internal Revenue Statutes (see accompanying Brief, Part 1).

[fol. 43] 2. This Court's ruling that federal tax statutes require bankruptcy trustees in liquidation to file tax returns for taxes were an obligation of a predecessor debtor in

possession, overlooked and failed to recognize the meaning and intent of the Statutes relating to the filing of tax returns (see accompanying Brief, Part 1).

3. The Court's Opinion requiring trustees to make returns for sums collected by others and to impose penalties and interest on a trustee in bankruptcy for his failure to file such returns violates the orderly procedure of administration prescribed by the Federal Bankruptcy Act (see accompanying Brief, Parts 1 and 3).

4. The Court failed to properly apply Section 378(2) of the Bankruptcy Act which relates to the time of accrual of rights of a trustee in bankruptcy in liquidation and was not intended to expand the duties of a liquidating trustee succeeding a debtor in possession (see accompanying Brief, Part 2).

5. This Court erred in its interpretation of Section 378(2) of the Bankruptcy Act in establishing a continuing identity for a liquidating trustee and his predecessor debtor in possession and overlooked the meaning and purpose of that Section which essentially is procedural and not substantive and furnishes no basis for imposition of duties on a trustee (see accompanying Brief, Part 2).

6. This Court in its ruling that a liquidating trustee in bankruptcy has the same obligation and duties as an operating debtor in possession overlooked and failed to consider the practical difficulties imposed by the Court's ruling on the trustee in a superseded Chapter XI proceeding.

[fol. 44] 7. This Court in its ruling that a trustee in a liquidating bankruptcy is required to pay tax prematurely, and not in the orderly manner contemplated by the Bankruptcy Act, places a trustee in a superseded Chapter XI proceeding in a unique position neither intended nor required by the applicable Federal Statutes (see accompanying Brief, Part 2).

8. The statement in the last paragraph on Page 4 of the Opinion of the Court dated May 25, 1965, to the effect that this Trustee contends that operating taxes of a debtor in possession should be treated as pre-bankruptcy taxes, is a misinterpretation of Appellee's position. This Petitioner categorically asserts that this is not and never was the position of appellee either in his Brief or argument of this cause. It has always been recognized that taxes incurred by a debtor in possession are entitled to priority under the first priority of Section 64 of the Bankruptcy Act as expenses of administration (note Trustee's Objections to Claim No. 8, Page 16, Record on Appeal).

9. This Court has not had an opportunity to consider the Opinion and reasoning of the United States Court of Appeals for the Eighth Circuit, in ***United States of America*** v. ***Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt,*** Cause No. 17,780 rendered June 4, 1965 (Appendix to accompanying Brief). The holding in the ***Kalishman*** case concerns the identical point raised in this Appeal but holds directly opposite to the decision which your Petitioner prays be reheard; and disallows the Government's claim for post-adjudication interest, recognizing that it disrupts the orderly administration of the Bankruptcy Act; is inequitable in result and is not supported by applicable legislation.

[fol. 45] Wherefore, Appellee prays that the Court withdraw and reconsider its Opinion of May 25, 1965, and on rehearing granted affirm the District Court.

John H. Gunn and Robert E. Venney, Attorneys for Appellee, 1534 Alfred I. duPont Building, Miami, Florida, By: Robert E. Venney.

CERTIFICATE OF SERVICE

It Is Hereby Certified that a true and correct copy of the foregoing Petition for Rehearing has been furnished by United States Mail, on this ..... day of June, 1965, to each of the following:

Louis F. Oberdorfer, Assistant Attorney General, Department of Justice, Washington, D. C. 20530.

William A. Meadows, Jr., United States Attorney, Federal Building, Miami, Florida.

Lavinia L. Redd, Assistant United States Attorney, Federal Building, Miami, Florida.

[fol. 76]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

[Title omitted]

ORDER DENYING PETITION FOR REHEARING—July 9, 1965

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

Per Curiam:

It is Ordered that the petition for rehearing filed in the above styled and numbered cause be, and the same is, hereby Denied.

[File endorsement omitted]

[fol. 77] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 78]

SUPREME COURT OF THE UNITED STATES

No. 650, October Term, 1965

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Petitioner,

v.

UNITED STATES.

ORDER ALLOWING CERTIORARI—January 17, 1966

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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B. The Internal Revenue Code of 1954:

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IN THE

Supreme Court of the United States

OCTOBER TERM, 19__

No. _____

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,

Petitioner,

versus

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To The Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, petitions for the issuance of a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit to review its Judgment entered in the above titled cause on May 25, 1965.

OPINION OF LOWER COURTS

1. The opinion of the Court of Appeals for the Fifth Circuit in this case United States of America v. John

Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt is reported in 346 F(2) 32. A copy of that opinion is contained in the Transcript of Record, page 33, and is also reproduced as Appendix A attached to this Petition. The Court of Appeals decision was on an appeal from an order of the District Court which affirmed a Referee in Bankruptcy. There were no formal opinions by either the Referee or the District Judge. The Order of the Referee is at page 19 of the Record and the Order of the District Court on Review is at page 25 of the Record.

JURISDICTION

1. The Judgment sought to be reviewed was entered by the United States Court of Appeals, Fifth Circuit, on May 25, 1965, 346 F(2) 32, and a timely Petition for Rehearing was denied by that Court on July 9, 1965 (R. 76).

2. Jurisdiction of this Court for this Petition for Writ of Certiorari is invoked on the basis of 27 U.S.C., Section 1254(1), and also Supreme Court Rule 19.1 (b), permitting Certiorari to Courts of Appeal when there is a conflict of opinions between the various Circuit Courts of Appeal. Petitioner contends the decision by the Court of Appeals for the Fifth Circuit in the instant case is in direct conflict with that of the Court of Appeals for the Eighth Circuit, in **United States v. Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankruptcy**, 346 F(2) 514 (CA 8, June 4, 1965), hereinafter designated the "Kalishman" case, App. C.

Further, this Court has jurisdiction to review the decision in question by virtue of 11 U.S.C.A., Section 47(c).

QUESTIONS FOR REVIEW

1. Whether the United States is entitled to recover from the assets of a bankruptcy estate, as part of a cost-of-administration claim, interest to date of payment on a claim for unpaid withholding taxes, FICA, FUTA and cabaret excise taxes, incurred by a debtor-in-possession, while operating a business during the pendency of an arrangement proceeding under Chapter XI prior to adjudication.

2. Whether a trustee in bankruptcy is liable for penalties for failure to file tax returns for the cabaret excise tax, FUTA tax and FICA-withholding taxes when the taxes were the liabilities of a predecessor debtor-in-possession.

STATUTES INVOLVED

The Statutes and Regulations involved in the consideration of this matter are listed below and set out verbatim in Appendix B.

Appx. Page

A. **The Acts of Congress relating to Bankruptcy:**

11 U.S.C., § 75(a) (Sec. 47a—Bankruptcy Act) Trustees; duties. 8

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority 10

11 U.S.C., §778 (Sec. 378 Bankruptcy Act) Procedure upon order directing that bankruptcy be proceeded with. 13

B. **The Internal Revenue Code of 1954:**

26 U.S.C., §3504, Acts to be performed by agents. 14

26 U.S.C., §4231(6), Cabarets. 14

26 U.S.C., §6011(a), General requirement of return, statement, or list. 15

26 U.S.C., §6012(b)(3), Receiver, trustee, & assignees for corporations. 15

26 U.S.C., §6601(a), Interest on underpayment, nonpayment, or extensions of time for payment, of tax 16

26 U.S.C., §6651, Failure to file return. 16

C. **The Judicial Code**

28 U.S.C., §960, Tax liability 17

D. Treasury Regulations on Employment Tax (1954 Code) 31-601(a)-1. 17

STATEMENT OF THE CASE

On August 6, 1958, the Beachcomber Motel, Inc., filed a voluntary petition for an arrangement with its unsecured creditors, under Chapter XI of the Bankruptcy Act. On September 17, 1958, upon its failure to submit a Plan acceptable to its creditors, the corporation was adjudicated a bankrupt. Between August 6, 1958 and September 17, 1958, the business had been operated by

the debtor-in-possession under the authority of the Bankruptcy Court.

The United States filed a claim for taxes in the subsequent bankruptcy proceedings (R-13). Included in the claim were pre-petition taxes accruing prior to August 6, 1958, the date of the filing of the Chapter XI and also a part described as "administrative expense taxes" which were for taxes that accrued during the debtor in possession period, between the date of the filing of the petition for arrangement and that of the entry of the order of adjudication on September 17, 1958.

The trustee in bankruptcy readily admits the propriety of allowance of pre-petition taxes and also the principal portion of the "administrative expense taxes". The Trustee objects to the portion of the claim of the Government which requests post adjudication interest and penalties on the "administrative expense taxes".

The debtor in possession incurred administrative tax liability to the United States in three areas: $519.89 for withholding and Federal Insurance Compensation Act (FICA) taxes; $644.00 for Cabaret or excise taxes; and, $362.29 for Federal Unemployment Tax Act (FUTA) taxes.

The Government, in addition, claimed assessed interest, accrued interest and assessed penalties on each of these particular taxes (R-13). The interest was claimed not only to the date of filing of the claim on April 11, 1963, but also thereafter until date of payment of the taxes. The assessed penalties were for alleged failure of the trustee in bankruptcy to file the respective tax

returns required of the taxpayer for the three tax liabilities.

The trustee in bankruptcy objected to that part of the Government's claim which sought penalties and accrued interest and interest to date of payment of taxes, all of which were post-adjudication impositions (R 16-21). The Referee sustained the objection and denied the Government's demand for interest to date of payment and penalties and allowed as an administrative expense the principal balance of the three taxes and assessed interest. The Referee was affirmed by the U. S. District Court and the Court of Appeals for the Fifth Circuit reversed.

It is the order of the Court of Appeals, Fifth Circuit, which the Trustee petitions this court to review on certiorari.

Jurisdiction of the federal courts below is based on their administration of the Bankruptcy Act, 11 U.S.C. § 1 et seq., proof and allowance of claims, 11 U.S.C. § 93, Bankruptcy Act § 57, review by the District Court of Orders of the Referee, 11 U.S.C. § 67, Bankruptcy Act § 39, and the Court of Appeals review as authorized by 11 U.S.C. § 47, Bankruptcy Act, § 24.

REASONS FOR ALLOWANCE OF WRIT OF CERTIORARI

INTRODUCTION

As has been noted, essential jurisdictional basis for this petition is the conflict of this decision with an almost simultaneous holding in the Court of Appeals for the

Eighth Circuit which disallowed the interest on withholding taxes that were allowed by the judgment of the Fifth Circuit.

The judgment on review from the decision of the Fifth Circuit and the decision of the Court of Appeals for the Eighth Circuit in U. S. v. Kalishman, 346 F(2) 514 App. C., decided June 4, 1965, both considered the status of claims by the United States for interest on withholding taxes that were incurred by a debtor in possession in a debtor relief proceeding under Chapter XI of the Bankruptcy Act. In both cases, the Chapter XI proceeding had been terminated, and superseded by a liquidating bankruptcy.

The Court of Appeals for the Fifth Circuit upheld the government's claim for post-adjudication interest and the Eighth Circuit denied such interest, leaving an unresolved conflict between the two decisions in the two Circuits.

In the case at bar, the issues also include the allowability of interest on FICA, FUTA and Cabaret taxes, as well as the question of responsibility of a trustee in bankruptcy to file returns for those various taxes on behalf of the debtor in possession after the debtor in possession administration had terminated. These additional features do not alter the legal principles applicable to both this case and the **Kalishman** decision.

In both conflicting decisions, the sums of money involved are relatively small, however the impact of the rule of allowing post-adjudication interest on claims in

bankruptcy compels the trustee to seek review in this court for resolution of the conflict.

The allowance of post adjudication interest on any claim in bankruptcy has generally been recognized as inequitable and a source of administrative difficulties. The practical problems inherent in allowing post-adjudication interest up to date of payment notwithstanding the specific allocations of priorities under the Bankruptcy Act is a consideration that usually persuaded the courts to deny claims for such interest.

The government's claims in this instance are accorded a specific priority under Sec. 64(a)(1) of the Bankruptcy Act. The effect of the decision of the Fifth Circuit in this case accords to the government a position superior to that specifically provided in the Bankruptcy Act. In effect, a super-priority is created which either requires the government's claim to be paid prematurely or allows a singular and unprecedented accumulation of interest until the claim is paid, notwithstanding the government's position on a well defined ladder of priorities.

I. THE BANKRUPTCY ACT SPECIFICALLY ALLOCATES PRIORITIES TO TAX CLAIMS AND A DEPARTURE FROM THE PRIORITIES OF THE ACT SHOULD BE AVOIDED IN FAVOR OF GIVING PRECEDENCE OF THE BANKRUPTCY ACT OVER OTHER STATUTES.

The inter-relation of the Bankruptcy Act and the Internal Revenue statutes was considered in City of New

York v. Saper, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710 (1949), with this observation:

> "We do not believe the revenue act of 1924 and similar enactments were intended to amend the comprehensive scheme of the Bankruptcy Act. ..."

The **Saper** case was a thorough treatment of the then existing bankruptcy statutes in their relationship to tax claims. Specifically, the **Saper** case decided that prepetition tax claims could not earn post petition interest in a liquidating bankruptcy. The purpose of bankruptcy proceeding being to collect the assets of the debtor and equitably distribute them to the creditors in accordance with prescribed priorities of the Act requires judicial determination that taxes accorded specific priority by Sec. 64 of the Act should be distributed in accordance with that particular statute. **Guarantee Title & T. Co. v. Title Guaranty & S. Co.**, 224 U.S. 152, 56 L.Ed. 706, 32 S.Ct. 457, considered the application of internal revenue statutes to bankruptcy proceedings. The government claimed that Sec. 3466 of the Revised Statutes governed bankruptcy distribution. The opinion rejected the government's position. **Davis v. Pringle**, 268 U.S. 315, 45 S.Ct. 549, 69 L.ed 974, was another attempt by the government to invoke provisions of Sec. 3466 of the Revised Statutes in an attempt to afford priority to tax claims under Sec. 64(a)(5) of the Bankruptcy Act. At that time, Sec. 64(a)(5) gave a fifth priority to "debts owing to any person who by the laws of the state or the United States is entitled to priority."

Other authority for the preference in application of

bankruptcy statutes over other Federal Statutes in bankruptcy proceedings is contained in **Adams v. O'Maley**, 182 F(2) 925 (8th Cir. 1950); **U. S. v. Bradley**, 321 F(2) 224 (CA 5, 1963); compare, also, **4 Collier on Bankruptcy**, § 67.24, page 239.

The logic behind such a rule is obvious and persuasive. If the intent of Congress expressed in its establishment of priorities under the Bankruptcy Act is to be followed, then distributions must be orderly and in accordance with those priorities, unless there is a clear, specific legislative expression to the contrary. General tax revenue statutes have not been used as a basis for altering the Bankruptcy Act's specifically prescribed outline of distribution. The allowance of interest on a tax claim after adjudication would constitute such an alteration and should not be permitted.

II. ALLOWANCE OF POST-BANKRUPTCY INTEREST ON TAX CLAIMS IS INEQUITABLE TO THE OTHER CREDITORS AND ADMINISTRATIVELY BURDENSOME.

The inequitable and impractical nature of allowing post-bankruptcy interest on any claim, tax or otherwise, is recognized in **City of New York v. Saper**, supra, which is the leading authority for the disallowance of post petition interest on tax claims. The **Saper** case involved taxes that accrued prior to the bankruptcy proceeding, unlike the taxes under consideration here. However, this is not a distinguishing feature. The controlling similarity of this proceeding with that in the **Saper** case is that in both situations the court deals with liquidating bankruptcies under Chapters I through VII of the Act. The rationale

of the **Saper** case is as much applicable here as it was in the proceedings then before this Court. The essential reasoning of the **Saper** case is that it is inequitable to allow the government interest on funds while those funds were in the hands of a trustee in bankruptcy.

Additionally, of course, **Saper** further recognizes the principle that liquidation of estates in bankruptcy requires that continuing obligations must cease at some point and debts be determined for the allocation of priorities and distribution. Otherwise, sound administration and distribution of dividends is impossible. See 3 **Collier** on **Bankruptcy**, § 63.16(2). Section 64 of the Bankruptcy Act awards a specific priority for taxes, whether they be pre-petition taxes accorded a fourth priority under Sec. 64a(4), or administration expense taxes accorded a first priority under Section 64a(1). The taxes are claims which should be treated as claims and accorded their respective priorities as directed by the Bankruptcy Act. The reasoning of **Saper** is followed in **United States v. Edens**, 342 U.S. 912, 96 L.Ed. 682, 72 S.Ct. 357, and also in **United States v. General Engineering & Manufacturing Co.**, 342 U.S. 912, 96 L.Ed. 682, 72 S.Ct. 358. **United States v. Edens**, supra, is a decision affirming a Fourth Circuit decision reported at 189 F(2) 876, in which the Court of Appeals recognized the inequitable nature of allowing interest on tax claims and held this rule applicable in reorganization proceedings as well as in straight bankruptcy proceedings. The Court stated that no single class of creditors should be able to benefit at the expense of another class of creditors, particularly when any delay in payment of claims was caused by application of an act of Congress and not by dilatory activities on the part of the taxpayer. This opinion strikes directly at the reason

assigned by the government in the instant facts for the timely payment of its taxes and the assertion that interest should be approved as a penalty for that non-payment. If the rule urged by the government is permitted to stand, it is not the trustee who is penalized for the non-payment, but the other creditors who have no control over the date of the payment of taxes. The inequitable and impractical effect of requiring interest on claims in bankruptcy proceedings, whether in reorganization proceedings or in straight bankruptcy, is well accepted and has received thorough recognition in all of the Federal decisions since that in the **Saper** case. Recently, the Court of Appeals for the Fourth Circuit, in **Smith** v. **Robinson** (CA 4 1965), 343 F(2) 793, denied post-petition interest on tax claims in a Chapter X proceeding, citing as authority **City of New York** v. **Saper,** supra, and other cases holding in accord therewith. The Fourth Circuit also, in **United States** v. **Harrington,** 269 F(2) 719, recognized the rule against post-petition interest on tax claims in order to prevent inequities and the suffering of other creditors because of that interest payment.

In addition to the statutory basis for denial of post petition interest, there of course exists in bankruptcy administration the inherent power of a bankruptcy court as a court of equity to determine how a debtor's assets should be distributed and it has generally been held that inequality results from payment of interest on obligations. A specific example is contained in **Vanston Bondholders Protect. Com.** v. **Green,** 329 U.S. 156, 91 L.Ed. 162, 67 S.Ct. 237, in which bondholders were denied interest notwithstanding their contractual obligation because of the inequitable result of denying such interest payments to other creditors with claims of equal dignity.

The *ratio decendi* of **Saper**, supra, the **Vanston Bondholders** decision, supra, and the other authorities supporting the repudiation of the inequitable result of allowing post adjudication interest on claims in bankruptcy, coupled with the administrative burden of calculating such interest has persuaded the courts to deny post-adjudication interest. This reasoning and proposition was, of course, well recognized by the Eighth Circuit in the **Kalishman** case, supra, App. C.

The only distinguishing feature that the Fifth Circuit finds in the facts at hand from those in the **Saper** case, supra, is that the liquidating bankruptcy administration under Chapters I through VII of the Bankruptcy Act supersedes a Chapter XI proceeding effort to make an arrangement with unsecured creditors.

The effect of the rule imposed by the Fifth Circuit in this opinion in conflict with the **Kalishman** decision is that the trustee in liquidating bankruptcy must pay, prematurely, and out of turn, claims for taxes which are even inferior in dignity to the expenses of the bankruptcy administration itself under the prescribed priorities of Section 64. The alternative, of course, is to incur a continuing obligation for interest to be paid out of the estate to the prejudice of other creditors some of whom are on equal priority status as the claim of the government.

The Government's claim here as an "expense of administration" was accorded Class 1 priority under § 64 of the Bankruptcy Act. It is limited only by the fact that it is an expense of a superseded debtor relief proceeding. That fact makes this claim junior to the expenses of the administration necessary for the liquidating bankruptcy.

Section 64(a) qualifies the expense of administration priorities and treats those at issue in this proceeding as follows:

> "Where an order is entered in a proceeding under any Chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; . . ."

The taxes under consideration here for Withholding, FICA, FUTA and cabaret taxes became returnable at a time after the termination of the debtor in possession Chapter XI administration and during the period of administration of the liquidating trustee in bankruptcy. If interest is permitted on the taxes from the date they are returnable, notwithstanding the fact that it is a date within the administration of a liquidating bankruptcy, the trustee is then faced with a dilemma. A payment of taxes prematurely by the Trustee may be at the peril of reducing his estate and not having sufficient assets to pay administration expenses superior to the tax claim. The other alternative is not to have sufficent assets to pay the administration expenses of equal dignity with the tax claim, thus forcing on those creditors a fractional share when the government, on the same priority level, received its claim in full.

To delay payment and incur interest as required

by the ruling of the Fifth Circuit, may result in a diminution of the fractional shares of the claims of equal dignity and certainly is a penalty against claims of inferior dignity, including those for wages, taxes of other governmental authorities, rent and unsecured creditors. This principle of forcing premature payment of taxes under penalty of incurring interest is not only completely alien to ordinary bankruptcy procedure but it is inequitable to creditors and, petitioner contends, without foundation in applicable law. The arguments which support the requirement that interest be paid on taxes to force timely payment is absent in these circumstances. Admittedly, the imposition of interest is a logical requirement to motivate the taxpayer to pay taxes.

Saper, Kalishman and other authorities disallowing interest, recognize that the persuasive reasons for interest accruing on unpaid principal of taxes is absent in a liquidating bankruptcy proceeding. If the entity incurring liability continues to exist and operate, imposition of interest is a logical requirement to persuade such continuing entity to pay its taxes. By way of example, the liability surviving bankruptcy for non-dischargeable taxes, or the liability of a continuing trustee in bankruptcy receivership proceeding are reasonable subjects for interest imposition. The distinguishing features between the allowance of post-petition interest on entities other than a liquidating bankruptcy trustee was recognized by this court in **Bruning** v. **United States**, 376 U.S. 358, 11 L.Ed. (2) 772, 84 S.Ct. 906. There, the court allowed post-petition interest on a continuing obligation of a debtor inasmuch as taxes are non-dischargeable in bankruptcy. The court specifically acknowledged the logic and persuasiveness of the **Saper** ruling in the liquidating trus-

tee situation. **Boetler v. Ingels,** 308 U.S. 57, 84 L.Ed. 78, 60 S.Ct. 29, is another instance where penalties were allowed on taxes but such allowance was against an operating trustee. The operating trustee failed to obtain a license to continue his business and the penalties were upheld during the continuing of his administration. Not considered, however, was the imposition of the penalties on a later liquidating bankruptcy proceeding. The Fifth Circuit opinion in this case (R 33, Appx. A) cited **Boetler v. Ingels,** supra, as authority for the imposition of interest and penalties on the liquidating trustee in this particular case. The opinion, however, does not recognize the distinguishing nature of the liquidating bankruptcy procedure as opposed to the continuing entity of a Chapter XI debtor in possession or a trustee or receiver. This distinction was specifically recognized by this Court in **Bruning v. United States,** supra.

The motivation to pay taxes created by the imposition of interest on the principal amount is absent in its application to trustees in liquidating bankruptcy estates. The straight bankruptcy trustee has a specific duty under the law to gather the assets and allot to the government its proper statutory priority. All of these activities are under the supervision of the court, to which the government has access to compel the trustee to more expeditious activity if there is a delay unwarranted by the circumstances.

The distinguishing nature of the liquidating straight bankruptcy in contrast to the continuing trustee operating a business or other continuing entity raises another problem not acknowledged by the Fifth Circuit in the opinion entered in this cause.

The trustee in bankruptcy is required under the duties contained in the Act to collect the assets of the debtor and then make equitable distribution in pro rata shares recognizing the scale of priorities set out in the Act.

To properly carry out this responsibility, it follows that liability on the various claims must at some point cease and allocation of shares take place.

This principle is fundamental in liquidating bankruptcies and there is no reason that it should not be applicable to a liquidating bankruptcy that succeeds an unsuccessful debtor relief proceedings. The rule established by the Fifth Circuit in this instance singles out this one exception and ignores the compelling practical problems inherent in the ruling which will necessarily complicate conclusion of such superseded bankruptcy proceedings. See 3 Collier on Bankruptcy, page 1855.

III. BANKRUPTCY ACT SECTION 378(2) IS NOT AN IMPOSITION OF DUTIES ON A TRUSTEE IN BANKRUPTCY AND THE PROVISIONS HAVE NO APPLICATION IN THIS CONTEXT.

Section 378 of the Act (11 U.S.C. §778) contains two sections. Sub section (2) is underconsideration in these proceedings as the original petition of the Debtor, Beachcomber Motel, was for a debtor relief proceeding under Chapter XI of the Act, or a Section 322 petition (See Appx. B. page 13).

The Court of Appeals for the Fifth Circuit invoked the provisions of Section 378 to impose the continuing in-

terest liability on a Trustee in Bankruptcy for the unpaid withholding taxes and other taxes incurred by the predecessor debtor in possession. The holding of the Fifth Circuit additionally imposes on the Trustee in Bankruptcy through interpretation of Section 378 a responsibility to file returns for the taxes claimed by the Government as "administrative expense taxes". The same general line of argument that applies to the interest imposition on the Trustee in Bankruptcy also is followed with respect to the requirement to file tax returns. The **Kalishman** opinion, supra, appendix C, also considered Section 378(2) and its application to facts identical to those at issue here, but rejected the Government's contention that Section 378(2) imposed obligations on a straight bankruptcy Trustee.

The purpose of Section 378 is to implement the transition from an active debtor relief proceeding into a straight bankruptcy proceeding under Chapters I through VII of the Act. This section defines the time when the rights of the Trustee in Bankruptcy accrue and relates them back to the time of the original petition under Chapter XI. **Miller** v. **Woolley**, (C.A. 9, 1944), 141 F(2) 837, described the effect of Section 378 as a retroactive adjudication in bankruptcy following the interpretation that Section 378 is nothing more than a relation of the time when the rights of the Trustee accrue. **Wood** v. **Scott** (C.A. 6, 1950) 180 F(2) 252, made the same application of that section.

The relation back of Sec. 378 solves the problem of whether the trustee in bankruptcy succeeds to property rights as of the date of adjudication, or as of the date of adjudication, or as of the date of the filing of the petition. Such a determination is necessary since at numerous

places, such as §64 of the Bankruptcy Act, prescribing a priority for wages and landlord's claims, all defined in relation to a fixed period of time prior to the petition, as well as the question of when property rights vest in a trustee, the trustee's status must be fixed with reference to one of the two dates.

§378 of the Bankruptcy Act resolves this by an expression of Congressional determination that the trustee, in the vesting of rights and in the administration of the estate has all of the powers he would have had, had not a debtor's relief provision, possibly under the aegis of the debtor in possession, supervened. A District Court, in the matter of **Goodrich Manufacturing Co.**, (DC Cal.) 168 F. Supp. 940, recognized the intent of Section 378 by holding that the Administration under an aborted Chapter XI proceeding was not binding on a Trustee to the extent that the meeting of creditors under the Chapter XI would constitute the first meeting of creditors as required under the Chapters I through VII of the Act. The first meeting is the time from which the claim period begins to run.

Two significant propositions should be considered in the application of Section 378. First is that Section 378 by its own terms is not mandatory, but requires that the proceedings after adjudication should be conducted "so far as possible" as if the original petition for adjudication had been filed at the time that the debtor relief petition was filed. Secondly, it is certainly a revolutionary expansion of the duties of the Trustee as required by Section 47 of the Act Appx. 8 to impose on the liquidating Trustee, the responsibiliy of the operating Debtor in Possession, including liability for continuing interest that would have been the obligation of a debtor in possession.

In this instance, as applied by the Fifth Circuit, the entire scheme of priorities elaborately developed in Section 64 of the Act, is disrupted and the sound basic reasoning behind the rule denying post petition interest so well developed and accepted in **New York** v. **Saper** and its supporting cases.

The expansion of the scope of Section 378 beyond the mere fixing of the date from which the Trustee's rights accrue in his administration of the liquidating bankruptcy, is unwarranted by the language of the Section and inconsistent with a reasonable and orderly administration of the Act.

IV. THERE IS NO STATUTORY DUTY REQUIRING LIQUIDATING TRUSTEES IN BANKRUPTCY TO FILE TAX RETURNS ON BEHALF OF A PREDECESSOR DEBTOR IN POSSESSION

The tax return requirement contained in the opinion of the Fifth Circuit to which this petition is directed, imposes on a Trustee in Bankruptcy a duty to file on behalf of his predecessor debtor in possession a tax return by the debtor in possession for withholding taxes, Excise Tax, F.U.T.A. and F.I.C.A. taxes. There is no such duty imposed on a Trustee in Bankruptcy by those Revenue Statutes prescribing the filing of tax returns. The pertinent provisions of the Internal Revenue Code requiring filing of tax returns as to cabaret taxes are contained in 26 U.S.C.A., Section 4231, subsection 6, appendix 14. As to withholding, F.I.C.A. and F.U.T.A. the applicable section for the filing of returns is 26 U.S.C.A., Section 6011, appendix 15.

No place does Congress impose the responsibility for filing those returns on any person other than the person receiving the income or collecting the revenue.

In the facts before the Fifth Circuit concerning the Beachcomber Motel, the person receiving the income or collecting the revenue, of course, was the debtor in possession under the Chapter XI proceedings.

If the debtor in possession administration had continued to the date when the returns were due, it would have been its officers' duty to file the returns and pay the tax as it would have been a continuing entity under the interpretation of **Boetler** v. **Ingles**, supra. Likewise, if the Trustee had conducted the business and incurred tax liability for the various taxes involved here it would have been his responsibility to file returns by the direct application of 28 U.S.C., Section 960, App. 17. The latter section qualifies its application to trustees "conducting a business". There is, of course, no showing that this Trustee in Bankruptcy conducted a business in the process of liquidating the estate of Beachcomber Motel.

In fact the arrangement failed and an adjudication was entered when the debtor was dispossessed and the motel operation closed altogether.

An example of the direct Congressional enactment imposing on a Trustee in Bankruptcy the obligation to file returns for their predecessors is contained in 26 U.S.C., Section 6012, App. 15. This section, of course, applies only to income taxes. No comparable provision has been found in the Internal Revenue Statutes as to withholding

F.I.C.A., F.U.T.A., or the cabaret taxes under consideration in this proceeding.

It then follows that the penalties claimed by the Government for failure to file tax returns should not have been upheld by the Fifth Circuit as there is no statutory authority requiring the filing of those returns by the liquidating trustee in bankruptcy and they are certainly not listed as one of his duties under Section 47 of the Bankruptcy Act.

CONCLUSION

The judgment of the Fifth Circuit has made a serious departure from long established precedent, by its holding that certain claims in bankruptcy shall draw interest to date of payment.

This ruling necessarily complicates the administration of any trustee liquidating a bankrupt estate if the liquidation superseded a debtor relief proceeding. The fundamental principle that some point must be reached when the trustee can assess the assets and calculate pro-rata distributions to all creditors has been overthrown in this one single instance.

Additionally the rule of the Fifth Circuit poses the other practical problem of forcing a dilemma on a trustee to either pay certain tax claims prematurely or incur interest as a penalty for non-payment. Confusion necessarily results if the assets of the liquidated bankruptcy are limited and priority creditors are reduced to fractional distributions.

The practical implications of the Fifth Circuit's holding may be onerous but the inequities that result from the imposition of interest is the most significant result of the holding.

To follow the rule of permitting interest to accumulate on certain tax claims penalizes every other creditor of any bankruptcy proceeding which follows an unsuccessful debtor relief proceeding. Creditors of equal priority status in the "administrative expense" category can have their share diminished if the estate is limited and of course every junior class in the priority ladder will always be penalized.

Interest is primarily a penalty imposed to persuade timely payment of taxes. In a liquidating bankruptcy the reason for the rule of interest is absent, thus statutory authority for its imposition should be clear, specific and unambigious.

§378 of the Bankruptcy Act merely establishes a time when property rights of a trustee in bankruptcy begin and it is the only legislative mandate suggested to alter the tax claims in the Beachcomber case from those in any other liquidating bankruptcy.

Thus imposition of interest on these bankruptcy "administrative taxes" is unauthorized and clearly inconsistent with the Bankruptcy Act plan of distribution.

Likewise the requirement imposed by the Fifth Circuit for a trustee in bankruptcy to file tax returns for his predecessor is without specific statutory mandate.

The decision of the Fifth Circuit in conflict with the *Kalishman* decision of the Eighth Circuit in the same area should be reviewed by this court. The conflict should be resolved and the long established sound rule denying post petition interest in bankruptcy should be reaffirmed by a reversal of the judgment in this case.

Respectfully submitted;

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By:_____
JOHN H. GUNN

APPENDIX A

In The

UNITED STATES COURT OF APPEALS

For The Fifth Circuit

No. 21777

UNITED STATES OF AMERICA,

Appellant,

versus

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,

Appellee.

Appeal from the United States District Court for the Southern District of Florida.

(May 25, 1965.)

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

TUTTLE, Chief Judge: On August 6, 1958, Beachcomer Motel, Inc., filed a petition for an arrangement proceeding under Chapter XI of the Bankruptcy Act. It was permitted to retain possession of the property as Debtor in Possession until, upon failure to submit an acceptable plan, the company was adjudicated a bankrupt

on September 17, 1958. During the intervening period of operation, the Debtor in Possession failed to make payment of certain taxes that accrued during this short period of operation. In fact, under the statute, the taxes that were collected or withheld for the quarter ending September 30, 1958, were not required to be included in returns to be filed until October 31, 1958. Others were to be returned by January 31, 1959. By this time, of course, the Trustee in Bankruptcy had succeeded to the duties of the former Debtor in Possession.

The Trustee failed to make the required returns and the Government filed an administrative expense statement of the taxes due covering the following amounts: $519.89 of withholding and FICA taxes (Federal Insurance Contributions Act) accruing between August 6, 1958, when the petition for arrangement was filed and September 17, 1958, when the taxpayer was adjudicated a bankrupt; $644 of cabaret excise taxes also accruing between the same dates, and $362.29 of FUTA (Federal Unemployment Tax Act) accruing during 1958. The aggregate of these items is $1,526.18.

Additionally, the United States stated as administrative expense, assessed interest on each of the three principal items above set forth in the amounts of $101.54, $17.58, and $4.46, respectively, totalling $123.58. These two sums, $1,526.18 principal amount of tax and assessed interest of $123.58, totalling $1,649.76, were allowed by the referee as an administrative tax claim entitled to first priority.

However, the referee sustained the trustee's objection to the Government's claim No. 51 as to the amounts set

forth as alleged penalties and accrued interest. Thus, the referee disallowed the following amounts contained in the Government's administrative expense statement of taxes due; namely, assessed penalty on the withholding and FICA taxes in the amount of $129.97, on the excise taxes in the amount of $161, and on the FUTA in the amount of $54.34, aggregating $345.31. The referee also disallowed interest after the date of the assessment and accrued to April 10, 1963 (the day before the date of filing of Claim No. 51) on the withholding and FICA taxes in the sum of $46.34, on the amount of excise taxes in the sum of $192.35, and on the amount of FUTA taxes in the sum of $99.55, totalling $338.24. Claim No. 51 also sought interest on the amounts due at the rate of 31 cents per day from April 11, 1963, the date of the filing of the claim.

The referee, as already stated, allowed as an administrative expense entitled to a first priority the principal amounts of the taxes and assessed interest. Thus, the only controversy here is with respect to his disallowance of the items of assessed penalties totalling $345.31 and interest accrued after the date of assessment, totalling $338.24, in all, $683.55 together with interest from April 11, 1963.

Upon a petition for review filed by the United States from the disallowance of these penalties and interest, the District Court affirmed the order of the referee.

As the Government points out, the distinction between taxes which accrue against a taxpayer prior to bankruptcy and those which accrue against a trustee after bankruptcy, has become well settled. Pre-bankruptcy taxes are pay-

able as tax claims against the bankrupt's estate under §57 of the Bankruptcy Act. 11 U.S.C.A. §93. They are entitled to payment as of the Fourth priority under §64a of the Act, 11 U.S.C.A. §104. If, however, a trustee becomes subject to taxes as a result of operations carried on after bankruptcy, these taxes constitute an expense of administration under §62a of the Act and, as such, are payable as a First priority under §64a.

The duty of the trustee in bankruptcy to pay taxes which accrue during the course of his administration, independent of tax claims which had accrued prior to bankruptcy, has long been recognized by the Supreme Court. See **Michigan v. Michigan Trust Co.**, 286 U.S. 334. Here, of course, the referee recognized this obligation, and properly required the payment of the principal amount of the taxes as an expense of administration. He drew the line, however, at the payment of interest on this principal amount of the taxes and additions to the tax, commonly called a penalty, arising from the failure of the trustee to make the necessary returns and payments on time.

The trustee here contends that since the taxes accrued while the Debtor in Possession was operating the corporation later to become bankrupt, rather than the trustee after bankruptcy, the taxes that accrued during this period should be treated as pre-bankruptcy taxes as should also, of course, the interest and penalties, if they are payable at all, when the failure to make the proper returns and payments is a failure of the bankruptcy trustee. As the Government points out, however, when a debtor is permitted to retain his possession under a Chapter XI arrangement proceeding, he is, within con-

templation of the law, just like a trustee, certainly to the extent of his obligation and duty to do the things that the statute would require of a trustee in possession. In fact, where a plan for arrangement turns out to be unsuccessful and an adjudication of bankruptcy is entered, §3782 of the Act provides that "the proceedings shall be conducted, so far as possible, in the same manner and with like effect, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this Chapter was filed; . . ." 11 U.S.C. §778. See **United States v. Sampsell**, 9 Cir., 193 F.2d 154. See also 8 Coll. on Bankruptcy (14 Ed. 1963 Rev.) Secs. 6.31 and 6.32 which states "the general purpose of §342 is that where a debtor continues in possession of his property, he shall be in fact a trustee. 'Its position as debtor, continued in possession, is for all practical purposes that of a trustee or receiver . . .' 'A debtor continued in possession by court order is a court officer analogous to a receiver or trustee.' A debtor in possession 'has all the powers of an ordinary trustee . . .'"

Thus, it is plain that the obligation of the trustee here was the same as if he had been in possession from the filing of the original Section XI proceedings. This being the case, it appears that the leading decision **Boteler v. Ingels**, 308 U.S. 57, answers the basic question whether the trustee is liable to the same obligation to make required returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face. We think it clear that he is so subject. The Supreme Court said in that case, "if businesses in California not conducted by a bankruptcy trustee are delinquent in the fees, they must pay the penalty. However, petitioners

contention would exempt a trustee operating a business in bankruptcy from this double-tax liability which other delinquents must bear. A state would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment." (p. 61)

We conclude that the principle announced in the **Boteler** case clearly applies here to the federal impositions. Thus, it follows that the referee and the trial court erred in not including the items listed above as costs and expenses of administration and thus payable under the First priority.

The judgment is REVERSED and the case is REMANDED for further proceedings not in consistent with this opinion.

[TITLE OMITTED]

JUDGEMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was urged by Counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

[TITLE OMITTED]

Issued as Mandate: May 25, 1965

(JULY 9, 1965)

ON PETITION FOR REHEARING

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

PER CURIAM:

It is ORDERED that the petition for rehearing filed in the above styled and numbered cause be, and the same is, hereby DENIED.

[TITLE OMITTED]

ON CONSIDERATION OF THE APPLICATION of the Appellee in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable Appellee to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, IT IS ORDERED that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate

of the clerk of the Supreme Court that certiorari petition and record have been filed. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

DONE AT NEW ORLEANS, LA., this 23rd day of July, 1965.

/s/ ELBERT P. TUTTLE
Chief Judge

(ORIGINAL FILED JULY 23, 1965)

APPENDIX B

The Statutes and Regulations necessary for consideration of the issues involved.

11 U.S.C. §75(a) (Sec. 47a Bankruptcy Act) Trustees; duties.

> (a) Trustees shall (1) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estates as expeditiously as is compatible with the best interests of the parties in interest; (2) deposit all money received by them in designated depositories initially in demand deposits; and subsequently, if authorized

by the court, in interest-bearing savings deposits, time certificates of deposit, or time deposits-open account; (3) account for and pay over to the estates under their control all interest received by them upon funds belonging to such estates; (4) disburse money only by check or draft on such depositories; (5) keep records and accounts showing all amounts and items of property received and from what sources, all amounts expended and for what purposes and all items of property disposed of; (6) set apart the bankrupts' exemptions allowed by law, if claimed, and report the liens and estimated value thereof to the courts as soon as practicable after their appointment; (7) examine the bankrupts (a) at the first meetings of creditors or at other meetings specially fixed for that purpose, unless they shall already have been fully examined by the referees, receivers, or creditors, and (b) upon the hearing of objections, if any, to their discharges, unless otherwise ordered by the court; (8) examine all proofs of claim and object to the allowance of such claims as may be improper; (9) oppose at the expense of estates the discharges of bankrupts when they deem it advisable to do so; (10) furnish such information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; (11) pay dividends within ten days after they are declared by the referee; (12) report to the courts in writing the condition of the estates, the amounts of money on hand, and such other details as may be required by the courts, within the first month after

their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority.

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estates subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under Chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable

under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the

their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

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under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the

term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; **Provided,** That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: **And provided further,** That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law:

Provided, however, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

11 U.S.C. §778(2) (Sec. 378(2) Bankruptcy Act). Procedure upon order directing that bankruptcy be proceeded with.

Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 721 of this title, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and
(2) in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 72 of this title.

Internal Revenue Code of 1954:

26 U.S.C. Sec. 3504. Acts to be performed by agents. (As amended by Sec. 71, Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606)

In case a fiduciary, agent, or other person has the control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees, employed by one or more employers, the Secretary or his delegate, under regulations prescribed by him, is authorized to designate such fiduciary, agent, or other person to perform such acts as are required of employers under this title and as the Secretary or his delegate may specify. Except as may be otherwise prescribed by the Secretary or his delegate, all provisions of law (including penalties) applicable in respect of an employer shall be applicable to a fiduciary, agent, or other person so designated but, except as so provided, the employer for whom such fiduciary, agent, or other person acts shall remain subject to the provisions of law (including penalties) applicable in respect of employers.

26 U.S.C. Sec. 4231. (6)—Cabarets.

A tax equivalent to 20 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of

such performance. The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. No tax shall be applicable under paragraph (1) or (2) on account of an amount paid with respect to which tax is imposed under this paragraph.

26 U.S.C. Sec. 6011. (a)—General requirement of return, statement, or list.

(a) General rule—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

26 U.S.C. Sec. 6012 (b)(3)—Receivers, trustees and assignees for corporations.

In a case where a receiver, trustee in bankruptcy, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

26 U.S.C. Sec. 6601(a). Interest on underpayment, nonpayment, or extensions of time for payment, of tax.

(a) General Rule. If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

26 U.S.C. Sec. 6651. Failure to file tax return.

(a) Addition to the tax. In case of failure to file any return or required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or a subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

28 U.S.C. Sec. 960. Tax liability.

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Treasury Regulations on Employment Tax (1954 Code):

§31.6071(a)—1 Time for filing returns and other documents. (a) Federal Insurance Contributions Act and income tax withheld from wages. (1) Quarterly or Annual returns. Each return required to be made under §31.6011 (a)—1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be made under §31.6011 (a)—4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve bank.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 17,780

UNITED STATES OF AMERICA,
Appellant,

v.

JEROME KALISHMAN, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt,
Appellee.

Appeal from the United States District Court for the Eastern District of Missouri.

[June 4, 1965.]

Before Vogel, Matthes and Ridge, Circuit Judges.

Ridge, Circuit Judge.

The sole question presented by this appeal is whether the United States is entitled to interest until date of payment of withholding taxes which accrued against the debtor while in possession of the business under an arrangement proceeding, and the interest did not begin to run on the tax until after the final adjudication in bankruptcy. Despite this simple statement of the problem here confronting us, the present case required an exhaus-

tive analysis of the present state of the law regarding post-bankruptcy interest claims. As appellee admits that "Appellant's statement of the case is essentially correct," the following facts are culled therefrom.

Seymour Wallas and Company, a corporation, filed a petition for an "arrangement" on June 24, 1960. Thereafter, it was adjudicated a bankrupt on March 16, 1961, having failed to submit an acceptable plan. On September 15, 1961, the United States filed a claim for taxes, separated into two claims—one for taxes accruing before the arrangement proceeding,—the other for taxes accruing during the arrangement. The latter claim is the only one in issue here. It was for assessed withholding taxes of $6,602.89 for the first quarter of 1961, plus $202.38 interest to the date of filing the claim, and interest of $1.06 per day thereafter until payment of the principal was made—ultimately on May 6, 1964. These taxes were not required to be reported or paid until April 30, 1961, subsequent to the adjudication in bankruptcy after failure of the arrangement proceeding; hence the interest here did not begin to accrue until that date. The Referee allowed the tax claim in the principal amount of $6,602.89 as an expense of administration of the arrangement proceeding but denied the claim for interest, basing his decision on *City of New York* v. *Saper*, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710 (1949). On petition for a review, the District Court affirmed in an unreported order. This appeal followed.

At the outset we are met with a jurisdictional question, raised by appellee in view of §24(a) of the Act,[1]

[1] 11 U.S.C.A. § 47(a).

which limits appeals in bankruptcy proceedings to matters involving more than $500.00 unless prior allowance of the appeal has been granted by the Court of Appeals. (See Rule 25 of this Court, 28 U.S.C.A., Rules, 8 Cir.) Since appellant claims interest to date of payment, it is readily apparent that substantially more than $500.00 is in issue here, even though the amount claimed was less than that sum at the time of filing the claim.[2] Regardless, this is an appeal which we can, and should, hear in our discretion, in the interest of substantial justice. *R.F.C.* v. *Prudence Group*, 311 U.S. 579, 61 S.Ct. 331, 85 L.Ed. 364 (1941); *New York Credit Men's Adjustment Bureau, Inc.* v. *Strauss & Co.*, 296 F.2d 702 (2 Cir., 1961). It is of sufficient importance to the future administration of the Bankruptcy Act(hereinafter denominated Act) to warrant our consideration thereof on its merits. *State of California* v. *Renauld & Co.*, 179 F.2d 605 (9 Cir., 1950).

Neither party questions the allowance of the principal amount of the taxes here considered as a proper expense of administration of the arrangement proceeding, entitled to a first priority under §64(a)[3] of the Act. They are taxes incurred while the property of the debtor was *in custodia legis* under the administration of the bankruptcy court, and thus are clearly expenses of administration as that term has long been understood. Cf. *Dayton* v. *Stanard*, 241 U.S. 588, 36 S.Ct. 695, 60 L.Ed. 1190 (1916); *State of Missouri* v. *Gleick*, 135 F.2d 134 (8 Cir., 1943); *United States* v. *Sampsell*, 266 F.2d 631 (9 Cir., 1959). See also, 3 Collier on Bankruptcy §64.105, p. 2088. It is appellant's contention that since under normal circum-

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[2] The accrued interest now claimed by the Government amounts to $1,172.28.

[3] 11 U.S.C.A., ¼ 104(a).

stances interest on unpaid taxes is considered an integral part of a tax liability itself, the interest here in issue should equally share that preferred status unless the fact of bankruptcy on the part of the taxpayer requires a different result.

In bankruptcy matters the Bankruptcy Act takes precedence over other statutes, and governs in any case where there might be conflict. *Guarantee Title & T. Co.* v. *Title Guaranty & S. Co.*, 224 U.S. 152, 32 S.Ct. 457, 56 L.Ed. 706 (1912); *Adams* v. *O'Malley*, 182 F.2d 925 (8 Cir., 1950); *United States* v. *Wood*, 290 Fed. 109 (2 Cir., 1923), aff'd 263 U.S. 680, 44 S.Ct. 133, 68 L.Ed. 503. Thus, in the matter of priorities the courts are bound by the terms of the Act, regardless of other statutory preferences. *Missouri* v. *Ross*, 299 U.S. 72, 57 S.Ct. 60, 81 L.Ed. 46 (1936); *Davis* v. *Pringle*, 268 U.S. 315, 45 S.Ct. 549, 69 L.Ed. 974 (1925). Present §64(a) of the act, *supra*, represents a clear departure from pre-Chandler Act practice, in that it reduces all costs and expenses of administration to a parity; that is, taxes no longer have a special priority over any other expenses of administration, all of which now share the same priority on an equal basis. *Missouri* v. *Earhart*, 111 F.2d 992 (8 Cir., 1940); *In re Columbia Ribbon Co.*, 117 F.2d 999 (3 Cir., 1941). Therefore, our consideration of post-bankruptcy interest in this tax claim can be no different than that of interest accruing generally as cost of administration on other like claims.

Considering interest in connection with bankruptcy, it appears that there is a ". . . long-standing rule against post-bankruptcy interest . . . implicit in our current Bankruptcy Act." *New York* v. *Saper*, l.c. 332. *In Vans-*

ton Committee v. *Green*, 329 U.S. 156, l.c. 163, 67 S.Ct. 237, 91 L.Ed. 162 (1946), the Court stated: "The general rule in bankruptcy . . . has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings." As said in *Bruning* v. *United States*, 376 U.S. 358, at 361-362: "As to claims against the trustee in bankruptcy, the general rule for liquidation of the bankruptcy estate has long been that a creditor will be allowed interest only to the date of the petition in bankruptcy . . ." and that *Saper*, *supra*, makes the general rule (applicable) "to claims against the trustee for taxes as well as for other debts." As the Court, in *Vanston Committee* v. *Green*, pointed out, this is a matter of equity . . . the delay in distribution being caused by law, and the estate should not be penalized for the delay by additional interest. In this connection, see *Sexton* v. *Dreyfus*, 219 U.S. 339, 31 S.Ct. 256, 55 L.Ed. 244 (1911); *United States* v. *Bass*, 271 F.2d 129 (9 Cir., 1959; *Massachusetts* v. *Thompson*, 190 F.2d 10 (1 Cir., 1951); 3 Collier on Bankruptcy, §63.16, p. 1858. There is also a matter of administrative convenience, as the very purpose of a "cut-off" or "bar" date would be thwarted if obligations are allowed to accrue past that date, continuing the vicious circle which bankruptcy was designed to terminate. This is not to say that such post-bankruptcy interest may never be allowed, for it is settled that the creditors' rights thereto will be recognized should the estate subsequently prove to be solvent, or should the estate itself subsequently receive income in the form of interest. *United States* v. *Harrington*, 269 F.2d 719 (4 Cir., 1959). We realize that the foregoing cases deal with interest which began to accrue prior to bankruptcy, on debts likewise accruing. Be that as it may, we think the broad policy and reasons therefor, toward post-bankruptcy interest,

should be kept in mind in the consideration of the specific issue in question here.

In the instant case we deal with a debt incurred as an expense of administration by a debtor in possession, the interest on which did not begin to accrue until after a subsequent adjudication in bankruptcy. By virtue of §378(2)[4] of the Act, the abortive arrangement proceeding and the subsequent bankruptcy are considered parts of a single proceeding so far as possible, and we must consider the debt here incurred by the debtor in possession as though it were contracted by the trustee during bankruptcy.

There is no question, of course, that a trustee is liable for taxes incurred during the administration of the estate, whether resulting from continuing to do business, or simple ad valorem taxes on the property in the estate. *Boteler* v. *Ingels*, 308 U.S. 57, 60 S.Ct. 29, 84 L.Ed. 78 (1939); *In re Chicago & N.W. Ry. Co.*, 119 F.2d 971 (7 Cir., 1941); *State of Missouri* v. *Earhart*, *supra*. Here, the question very simply is whether the Government is entitled to interest on such taxes after straight bankruptcy has been adjudicated, until the date of payment of the taxes accruing during an arrangement proceeding.

In 1949, the Supreme Court handed down the decision in *City of New York* v. *Saper*, *supra*. Since that time, the *Saper* decision has been variously considered in lower federal courts on numerous occasions. Such cases, of which the present is apparently the latest, involved the contention that the very broad language of *Saper* should

[4] 11 U.S.C.A., § 778(2).

be restricted to the specific situation involved there, but it should be noted that in each case thereafter the courts have taken the language of *Saper* at face value and accepted the rationale thereof, wherever logically required to do so. See, for example, *United States* v. *General Engineering & Mfg. Co.*, 188 F.2d 80 (8 Cir., 1951), aff'd 42 U.S. 912, 72 S.Ct. 357, 96 L.Ed. 682; *United States* v. *Edens*, 189 F.2d 876 (4 Cir., 1951), aff'd 342 U.S. 912; *State of New York* v. *Feinberg*, 204 F.2d 502 (2 Cir., 1953).

The *Saper* case involved the question of post-bankruptcy interest on taxes accruing prior to straight bankruptcy. The Court, in denying such interest, noted that prior to the Chandler Act, interest was commonly allowed, based on the especially preferred status of taxes under the Act of 1898, and further, that lower federal courts had continued to do so even after the Chandler Act. However, in *Saper* it clearly held such practice to be in error, as being in violation of the long-standing bankruptcy tradition that accrual of interest against the estate ceases on the inception of bankruptcy as a matter of equity and practicality. Each of the cases subsequently considering *Saper* have likewise been concerned with straight pre-bankruptcy tax debts, and we are not cited to, nor have we found any subsequent cases specifically dealing with an issue situation such as here present. We think it necessary to remember, however, that the Court in *Saper* considered with favor the "long-standing rule" against post-bankruptcy interest based on equitable considerations.

Appellant asserts that *Boteler v. Ingels, supra*, is authority for allowance of the interest attempted to be collected here. In that case the Court held that a trustee

in bankruptcy was liable for state penalties imposed for nonpayment of automobile license fees when the fees and penalties accrued during the operation of the business by the trustees for the purposes of liquidation. We are also referred to *In re Chicago & N.W. Ry. Co., supra*, holding, on the authority of *Boteler*, an estate in bankruptcy was liable for the penalties on overdue state taxes accruing after the institution of the bankruptcy proceedings. Both of the above cases were mainly premised on the provisions of the predecessor statute of 28 U.S.C.A., §960, which provided generally the same as present §960.[5] The reasoning of the Court in the above-cited cases was that §57(j)[6] was applicable only to penalties incurred by the bankrupt individually prior to bankruptcy, and that it was not applicable to penalties brought on by the action of the trustee himself. In such instance, the provisions of §960 of Title 28 were held to prevail. Without speculating as to the "intent" of the Supreme Court in *Saper* (which opinion did not mention *Boteler*), we believe the present case to be distinguishable from *Boteler*, and to come under the reasoning laid down in *Saper* without doing violence to *Boteler*. Our understanding of *Boteler* is that it holds simply that a trustee operating a business is subject to tax statutes, the same as any other citizen, and subject to penalties if he does not comply with the law. Such is not the issue in the present case.

Here, we deal with "interest" after adjudication, within the concept of ". . . compensation for the use of forbearance of money." *Deputy* v. *duPont*, 308 U.S. 488,

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[5] "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation." 28 U.S.C.A. § 960.

[6] 11 U.S.C.A., § 93(j).

498, 60 S.Ct. 363, 84 L.Ed. 416 (1940); *C.I.R.* v. *Meyer*, 139 F.2d 256 (6 Cir., 1943). *Boteler* deals with a "penalty" as punishment for wrongdoing. *United States* v. *Chouteau*, 102 U.S. 603, 26 L.Ed. 246 (1881); *Unemployment Reserves Commission* v. *Meilink*, 116 F.2d 330 (9 Cir., 1940). The long-standing rule followed in *Saper* is concerned with interest after adjudication, not penalties as accrued in *Boteler*. Certainly, no argument can be made that malfeasance by a trustee in bankruptcy is never to be allowed pecuniary reimbursement in a bankrupt estate, to the extent of actual loss caused thereby, if the trustee undertakes to act contrary to law. This is what is ruled in *Boteler*. Here, appellant's claim is wholly related to the concept of interest (i.e. reimbursement for the use of money), which interest commenced to run after the date of adjudication in bankruptcy. True, the statute *supra* gives taxes a priority . . . and they are to be paid as soon as possible . . . If not so paid in a straight bankruptcy proceeding, any delay therefor can only be traced as caused by the law, not by the bankruptcy estate. This is the important distinction we find in the facts here. Paying taxes at the normal distribution time for debts of like priority, as ordered by the Court, creates quite a different situation than the affirmative violation of operating motor vehicles on the highways of a state without paying the necessary state motor vehicle license taxes.

Bruning v. *United States*, *supra*, does not require a *contra* ruling. There, interest on tax claims for the period from the filing of a petition in bankruptcy to the date of payment of the principal tax claim was recovered by the Government out of assets personally acquired by the tax debtor *after* his adjudication of bankruptcy, in the light of §6873(a) of the Internal Revenue Code of 1954 (26

U.S.C.A. §6873(a)). The facts and applicable law in *Bruning* do not militate against the ruling made in *Saper*. As the Court points up in *Bruning*, that "case concerns the debtor's personal liability for post-petition interest on a debt for taxes which survives bankruptcy to the extent that (the tax) is not paid out of the estate." (Par. added.) 376 U.S., l.c. 362. Here, we are concerned with pro rata distribution of assets of a bankrupt's estate among preferred creditors, having equal priority as required by §64(a) of the Bankruptcy Act, *supra*.

Appellant's argument that this interest should be enforced because of the trustee's willful refusal to pay the tax immediately when due, is without merit. The Government, as a creditor in bankruptcy, occupies no favored position over other creditors of like priority. *State of Missouri* v. *Earhart*, *supra*. There is nothing in this record to suggest that the tax in question was not given the same consideration as other costs of administration which occupied the same priority. To allow this interest would be in effect to charge the estate with interest, because the trustee complied with the terms of the Bankruptcy Act and refused to give the taxes a special priority not sanctioned by the Act. Allowing this interest would be to place the trustee in the unenviable position of being forced to choose between his responsibility to conserve the estate, and creating a new priority for taxes, or strictly abiding by the statutory scheme for the payment of all debts of equal priority in bankruptcy estates.

Whether the tax accrued before bankruptcy or subsequent thereto, the evil propagated by continually accruing interest remains the same. In neither case is it logical to charge a bankrupt estate a fee for the use of money when

it is the force of law which prevents the return of the principal to the creditor, rather than the desire of the debtor to retain its use. In light of the policy enunciated in *Saper*, we believe the referee was correct in denying interest on this tax claim. *Collectibility of Post-Bankruptcy Interest*, by Max Schwartz, Vol. 36, No. 2, p. 49, Jour. Nat'l Ass'n of Referees in Bankr.

In the alternative, the Government asserts that by the principal amount of the tax here withheld, and the interest thereon, constitute a trust fund in the hands of the trustee to which the United States as *cestui* has an absolute right, independent of any questions of priority, citing: *City of New York* v. *Rassner*, 127 F.2d 703 (2 Cir., 1942), construing a city ordinance making the vendor a trustee when collecting city sales tax from vendees; and *United States* v. *Sampsell*, 193 F.2d 154 (9 Cir., 1951), construing the predecessor statute of present §7501(a), *supra; Hercules Service Parts Corp.* v. *United States*, 202 F.2d 938 (6 Cir., 1953), as to withholding tax; and *In re Airline-Arista Printing Corp.*, 156 F.Supp. 403 (D.C. N.Y., 1957), aff'd 267 F.2d 333, also concerning withholding tax. These cases, all following *New York* v. *Rassner*, *supra*, hold that withheld tax funds constitute trust funds in favor of the taxing authority. Although the argument against allowing such statutory trusts to change the scheme of priorities in the Act is quite convincing,[8] we do not believe that question is present in this case. Whether or not these withheld funds constituted a trust fund for the benefit of the United States is rendered moot

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7 "(a) General Rule.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of the tax so collected or withheld shall be held to be a special fund in trust for the United States . . ."

8 See Note 27, p. 2066, 3 Collier on Bankruptcy.

by the fact that the principal of the fund is not in issue here, and has in fact been paid over to the Government. As we have determined that the Government is not entitled to interest as here claimed, there are no further funds in issue, and thus no reason to reach the question as to whether or not a trust was created.

For the reasons noted, the decree of the referee as adopted by the District Court is

Affirmed.

In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 650

JOHN NICHOLAS, TRUSTEE OF THE ESTATE OF BEACHCOMBER MOTEL, INC., BANKRUPT, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

In this case a debtor in possession which operated its business during an arrangement proceeding under Chapter XI of the Bankruptcy Act incurred liability for federal taxes which it withheld on wages earned by its employees and for excise taxes. The arrangement proceeding failed, and the debtor was adjudicated a bankrupt before the taxes involved became due. The trustee in bankruptcy neither timely filed tax returns nor paid the taxes. The court of appeals held that (1) the taxes themselves, (2) the interest thereon to the date of payment, and (3) the statutory penalties for failure to file timely returns, all con-

stituted expenses of administration payable as a first priority claim under Section 64a of the Bankruptcy Act (11 U.S.C. 104).

The holding below that the government's claim for interest is an expense of administration entitled to first priority in payment conflicts with *United States* v. *Kalishman*, 346 F. 2d 514 (C.A. 8). The government has filed a petition for certiorari in *Kalishman* (No. 711, this Term, filed November 1, 1965), and review of that question in this case also is appropriate.

On the penalty issue (the second question presented) there is no conflict of decisions (*Kalishman* involves only interest, not penalties). We agree with the court of appeals (Pet. App. 5–6) that this aspect of the case is governed by *Boteler* v. *Ingels*, 308 U.S. 57. See, also, *City of New York* v. *Rassner*, 127 F. 2d 703 (C.A. 2). The two issues are closely related, however. The government's theory is that the trustee's duties include the payment of taxes incurred during the operation of the business under the arrangement proceeding (see Section 378(2) of the Bankruptcy Act (11 U.S.C. 778(2)) and the opinion of the court of appeals, Pet. App. 5); that such duties also embrace the obligation to file timely returns covering such taxes and to pay them when due; and that penalties for failure to file timely returns and interest on the taxes until paid are just as much expenses of administration as the taxes themselves. In these circumstances, we think that, if the Court reviews the interest question, it should also consider the penalty issue—

an issue also likely to arise frequently. See the petition in *Kalishman*, pp. 6–7.

We therefore do not oppose the petition. We believe, however, that because the issues are quite narrow, it would be appropriate for the Court to hear only a single case, and we therefore suggest that the Court should consider deferring action in *Kalishman* until it has decided the present case.

Respectfully submitted.

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JOHN F. DAVIS, C

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965.

No. [redacted] [redacted] 650

JOHN NICHOLAS, Trustee of the Estate of BEACHCOMBER MOTEL, INC., Bankrupt,

vs.

UNITED STATES OF AMERICA.

BRIEF

On Behalf of Jerome Kalishman, Trustee in Bankruptcy of Seymour Weiss and Company, Bankrupt, Respondent in Cause No. 711, October Term, 1965, as Amicus Curiae.

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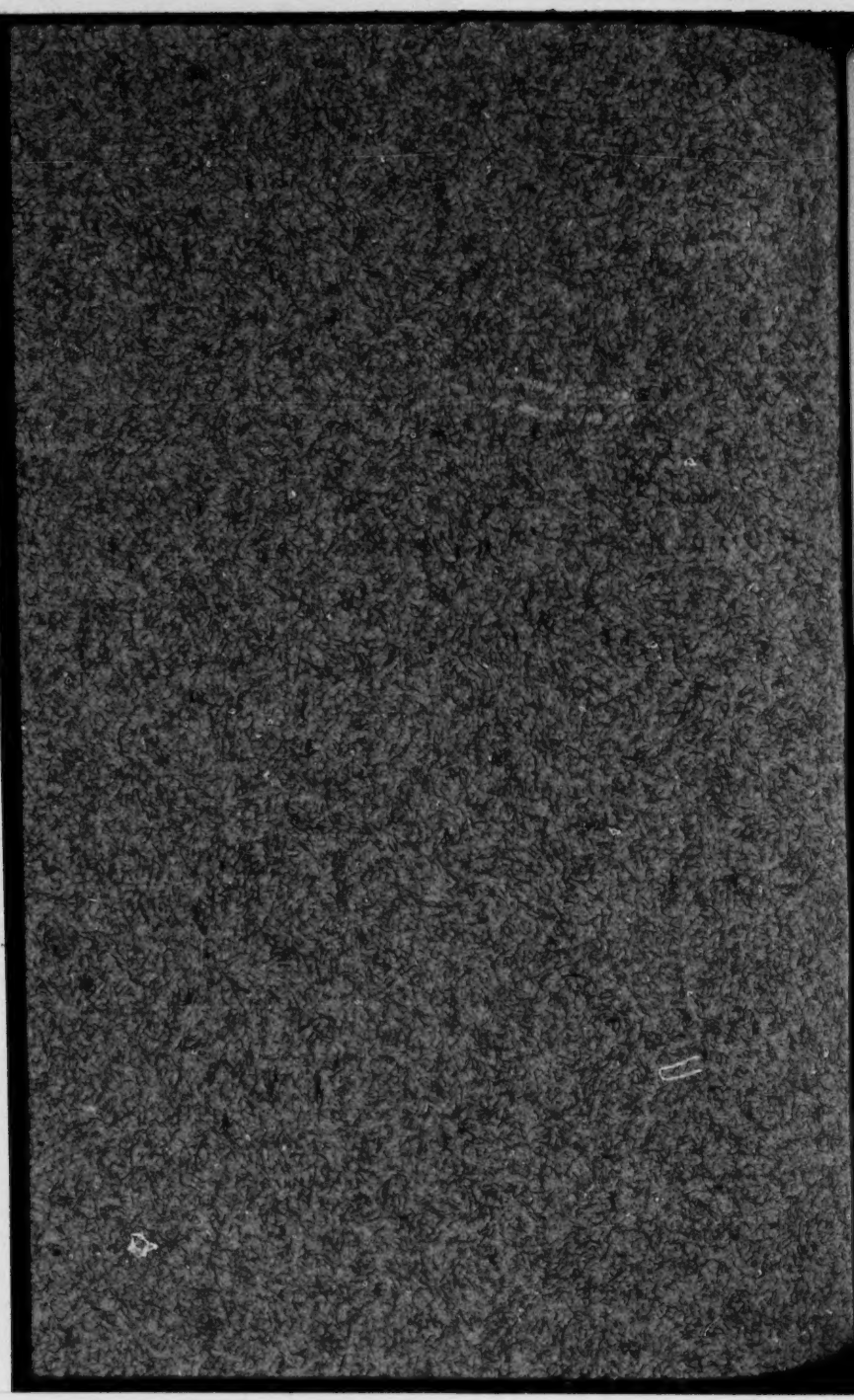

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1965.

No. 650.

JOHN NICHOLAS, Trustee of the Estate of BEACHCOMBER MOTEL, INC., Bankrupt,

vs.

UNITED STATES OF AMERICA.

BRIEF

On Behalf of Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt, Respondent in Cause No. 711, October Term, 1965, as Amicus Curiae.

I.

INTEREST OF JEROME KALISHMAN, TRUSTEE IN BANKRUPTCY OF SEYMOUR WALLAS AND COMPANY, BANKRUPT.

Pursuant to the order of this Court of January 17, 1966, extending an invitation to the undersigned as respondent in the case of United States v. Kalishman, Trustee in

Bankruptcy, etc., No. 711, October Term, 1965, to submit a brief in this proceeding, as amicus curiae, the undersigned herewith submits this brief in support of John Nicholas, Trustee, etc., in Cause No. 650, October Term, 1965. We agree that the issues in both cases are identical.

II.

THE QUESTION PRESENTED.

The question at issue is whether the United States is entitled to recover from the assets of the bankrupt estate as part of a cost-of-administration claim, interest on a claim for unpaid withholding taxes incurred in a proceeding instituted under Chapter XI of the Bankruptcy Act by a debtor retained in possession.

The Eighth Circuit Court of Appeals decided the issue in favor of the undersigned in the case of **United States of America v. Jerome Kalishman, Trustee,** 346 Fed. (2d) 514.

III.

STATEMENT OF THE CASE.

In the Nicholas case, and in the Kalishman case also, debtor corporations filed petitions instituting proceedings under Chapter XI of the Bankruptcy Act. In each proceeding orders were made continuing the debtor in possession. The debtor in possession in each case operated its business and incurred liabilities for taxes after the petition was filed. The obligations to the United States for such taxes were not paid when due. This gave rise to a claim on behalf of the Government for interest during the period that the claims remained unpaid. Question has arisen as to whether the Government is entitled to interest. In each case the proceeding for an arrangement under Chapter XI failed, resulting in a subsequent adjudication in bankruptcy, and any burden resulting from the payment of interest will ultimately fall upon the general creditors of the bankrupt rather than upon the debtor or any successor of the debtor.

IV.

ARGUMENT.

A.

Where a Chapter proceeding in bankruptcy is superseded by an adjudication, all costs of administration including tax [illegible]ncurred during the operations of the debtor-in-possession are on a parity.

We respectfully submit that the learned Judges of the Fifth Circuit Court in deciding the Nicholas case overlooked or did not give effect to the rule that where Chapter proceedings in bankruptcy are superseded by an adjudication, all costs-of-administration, including costs incurred during the operations of the debtor in possession, are on a parity. The Government does not have in such a case the priorities that it has under Section 64a of the Bankruptcy Act (11 U. S. C. § 104a). Throughout these two cases the Government has taken the position that the trustee should have paid forthwith the tax claims resulting from the operations of the debtor in possession without first ascertaining whether or not ultimately there would be sufficient funds to pay other costs-of-administration claims. Congress has not seen fit to extend to tax claims incurred during operations in a Chapter XI proceeding the same priority which the Government has in straight bankruptcy and in other insolvency proceedings.

Under the authorities it is clear that where a Chapter proceeding under the Bankruptcy Act is superseded by liquidation, all obligations including tax obligations incurred during the operation in the Chapter proceeding are on a parity as costs of administration.

State of Missouri v. Earhart (C. C. A. 8), 111 F. (2d) 992, cert. den. 311 U. S. 676, 85 L. Ed. 435, 61 S. Ct. 43;

In re Columbia Ribbon Co. (C. C. A. 3), 117 F. (2d) 999, 1001;

In re Lambertsville Rubber Co. (C. C. A. 3), 111 F. (2d) 45.

In the Earhart case the Court emphasized (111 F. (2d) at p. 995) that where a straight bankruptcy liquidation follows a Chapter proceeding the claim of a sovereign has no priority over other cost of administration claims, that on the question of priorities the provisions of the Bankruptcy Act govern.

The danger of a premature payment of a tax claim is ably discussed by Judge Biggs in the Lambertsville case.

See also:

In re West Coast Cabinet Works (D. C. Calif.), 92 F. Supp. 636, footnote p. 659.

B.

In bankruptcy, claims for priority are strictly construed, and usually the prompt payment of the principal amount of the government's claim is impossible.

Section 354 of the Bankruptcy Act (11 U. S. C., § 754) covers the filing of claims due and owing at the time of the filing of the original petition. There is no provision in the Act for the filing of cost of administration claims and no time limitation compelling the filing by any particular date. Neither is there any provision in the Bankruptcy Act requiring that the debtor-in-possession or any other party file a schedule or list of cost-of-administration claims, so the Referee and the trustee are totally in the dark until the close of the administration as to what obligations have been incurred. The usual procedure is for a trustee to apply for and cause to be published a "bar order", fixing a final date for the presentation of claims incurred while the debtor-in-possession was operat-

ing, but as a matter of fairness and equity a trustee should not attempt to bar the presentation of such claims until the estate is ready to be closed.

The point we make is, that until an estate is ready for closing neither the Bankruptcy Court nor the trustee of such an estate as this can possibly know whether there are sufficient funds on hand to pay, first, the expenses of the bankruptcy administration, and secondly, the cost-of-administration claims. Even at best some guessing has to be done if costs of administration are to be paid before the expenses of administration have been determined, for the claims of receivers, attorneys for the receivers, trustees, and attorneys for the trustees are all determined after notice to creditors at the final meeting. Then and not until then can an order of distribution be made.

It so happens that on occasions operations by a debtor-in-possession are unfortunately unsuccessful. If the trustee has paid any one or more of the cost-of-administration claims in full, and then it turns out that there are insufficient funds to pay all of such claims in full, some of such creditors have been treated unfairly and the trustee will be liable on his bond.

The decision in this Court in the case of **King v. United States**, 379 U. S. 329, 85 S. Ct. 427, 13 L. ed. 2d 315, has a bearing on the issues here before the Court. In the King case the Supreme Court held that a distributing agent in a Chapter XI proceeding was liable for failing to pay a claim of the United States in full. The United States was placed in jeopardy because other creditors having a lower priority were paid by the distributing agent. The liability fixed upon the distributing agent was a personal liability placed upon him.

We offer these comments. In the King case the distributing agent was held liable for paying second priority

claims ahead of first priority claims, and Justice White in a concurring opinion gave some weight to the fact that the distributing agent had knowledge of all the facts.

Thus it was held that one in a fiduciary capacity in a bankruptcy proceeding who pays second priority claims without ascertaining and paying first priority claims first, is liable. It is to avoid such a liability that a trustee in bankruptcy must necessarily withhold paying the government's claim until he can ascertain what the amount of the first priority claims are.

There is another important distinction. The court in the King case placed emphasis upon the fact that the distributing agent had sole control of the funds. That was not true in the case at bar, because where there has been an adjudication in bankruptcy the Referee's signature to checks is required. In the King case this does not appear to have been true. Under General Order in Bankruptcy No. 29 checks of a trustee must be countersigned by the judge or by a referee or by a clerk under an order made by the judge.

In that connection also we refer with emphasis to Section 39a (5) of the Bankruptcy Act (11 U. S. C., § 67a (5)), wherein it is provided that it is the duty of the Referee to declare dividends and cause to be prepared dividend sheets showing the dividends declared and to whom payable. Thus it will be seen that under the law the administration of funds in a straight bankrupty proceeding is under the control of the Court.

We cannot with assurance comment upon the situation in the Nicholas case, but we know that in the Kalishman case the Referee in Bankruptcy could not have permitted payment to be made to the United States because the Referee had no way of knowing, nor could the trustee have assured him, that there would be sufficient money in the estate to pay all other cost-of-administration claims

in full. The aggregate amount of cost-of-administration claims could not be determined until the estate was ready for closing.

The position of the Government is that it is the duty of the trustee to pay the tax claim in full at once even though there may not be enough funds on hand to pay other claims which are on a parity with the Government's claim.

If the United States was entitled to immediate payment of its cost of administration claim, all other holders of cost of administration claims, being on a parity, were likewise entitled to be paid at the same time, and what is a trustee to do, at the outset of his administration, before he has liquidated the assets of his estate, when he has no money in the bank?

The Government contends that under such circumstances the estate must pay interest. This must come out of the pockets of general creditors. We say that this attitude is unconscionable, and that the Bankruptcy Court as a court of equity should not sanction and enforce such a theory. The Government is seeking a priority to which it is not entitled even if it could be ascertained beyond doubt that the funds in the trustee's are sufficient to pay all cost-of-administration claims in full, because it demands to be paid before the Court is prepared to order payment of other claims on a parity with the Government's claim. This would be giving the United States a priority in time of payment not authorized by law.

The law does not sanction such a result.

An essential purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate and that no claimant is to be preferred over others unless the Bankruptcy Act by its terms requires such a result; and there is a rule that a priority of a claim against the

bankrupt for taxes due is to be strictly construed and that the burden of establisihng a priority is upon the claimant.

> Standard Oil Company v. Kurtz (C. C. A. 8), 330 F. (2d)178.

Priorities in bankruptcy are determined by the provisions of the Bankruptcy Act, and for the United States to establish a priority it must look to the provisions of that Act in order to establish it.

> Davis v. Pringle, 268 U. S. 315, 69 L. Ed. 974, 45 S. Ct. 549.

The Government argues the liability to pay tax incurred as a cost of administration is imposed upon the trustee in bankruptcy upon adjudication rather than upon the debtor-in-possession, but the liability upon the trustee is merely to recognize such a tax as a cost of administration, and if the funds are not sufficient, to pay the taxing authority its pro-rata share, and then only on order of court.

The Government completely ignores the 1952 amendment to Section 64a (1) of the Bankruptcy Act (11 U. S. C. § 104a (1)) which provides:

> "Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration * * *."

This points up the impossibility in many cases of paying expenses of administration claims under Chapter XI until the court is reasonably certain that there will be sufficient funds to pay priority expenses first, and then cost-of-administration claims in full.

C.

It is inequitable for a bankruptcy court to allow post-bankruptcy interest on tax claims where the burden of the payment would fall upon other creditors.

City of New York v. Saper, 336 U. S. 328, 93 L. Ed. 710, 69 S. Ct. 554, established new law. Prior to the Saper case it was generally held that the United States was entitled to interest on its tax claim until payment was made or until the claim was barred by limitations. This was conceded in the opinion (336 U. S. at p. 333, 93 L. Ed. at p. 716). The real basis for the decision in the Saper case was, that it was inequitable to allow the Government interest on funds while those funds were in custodia legis. The court pointed out that to allow the Government interest on its claim would give the Government preferred treatment over other claimants and that there was nothing in the law which justified the conclusion that Congress intended to give the Government preferred treatment.

We recognize the fact that the Saper case involved post-bankruptcy interest on a claim which arose prior to bankruptcy. Other cases which we shall cite are similar in that respect. But the fundamental reasoning behind these cases applies to the case at bar. The philosophy of the Saper case is just as applicable here as to those cases which involve interest on claims existing at the time of bankruptcy.

The Saper case was followed in short order by **United States v. Edens,** 342 U. S. 912, 96 L. Ed. 682, 72 S. Ct. 357, and by **United States v. General Engineering & Manufacturing Co.,** 342 U. S. 912, 96 L. Ed. 682, 72 S. Ct. 358. In General Engineering the court was considering the allowance of a tax claim in a Chapter XI proceeding, and as in the Saper case, the claim arose prior to bankruptcy. The court held there should be no distinction between

ordinary bankruptcy and Chapter XI cases and cited in support of its conclusion Section 302 of the Bankruptcy Act (11 U. S. C., § 702), which provides that the provisions of Chapters I to VII of the Bankruptcy Act should apply to Chapter XI proceedings insofar as those provisions are not inconsistent with the provisions of Chapter XI.

From the plethora of litigation which continued to arise after the Saper case, apparently the Government was not satisfied with that decision. We shall not attempt to refer to all of the cases, but we shall cite some of them which evidence the philosophy of the courts and the reasoning behind the decisions.

State of New York v. Feinberg (C. C. A. 2), 204 F. (2d) 502, was a Chapter X proceeding in which the State of New York objected to a plan of reorganization that provided for the issuance of debenture bonds upon the State's claim for taxes to bear interest at the rate of only six percent per annum instead of a higher rate provided for by New York Law. The decision seems to hold that since the State of New York was not under the law entitled to interest at all after bankruptcy, it could not complain at the rate at which the rate of interest was revived.

The Sixth Circuit Court of Appeals in the case of **In re Inland Gas Corporation,** 241 F. (2d) 374, points out that so far as interest is concerned debts due for taxes are on a par with other debts of the bankrupt, and citing the Vanstone Bondholders case, to which we shall refer later, it was held that the court should consider and balance the equities between the parties.

In re Huff Co., 96 F. Supp. 701 (D. C., Mich.), is an important District Court decision in which the court held that in determining the right of the United States to interest the rule disallowing post-bankruptcy interest is an equitable one, not only in bankruptcy cases aimed at liqui-

dation but those involving Arrangements, and that the rule of the Saper case is one based upon equitable principles.

The Fourth Circuit Court of Appeals in **United States v. Harrington**, 269 F. (2d) 719, declares that the rule against post-bankruptcy interest upon tax claims is designed to prevent other creditors from suffering by the allowance of post-bankruptcy interest.

In a Fourth Circuit Court case decided prior to the Saper decision, **Littleton v. Kincaid**, 179 F. (2d) 848, the court held that interest should not be paid out of fund in custodia legis because of the inequality that would result. In the more recent Ninth Circuit case of **Beecher v. Leavenworth State Bank**, 192 F. (2d) 10, a farmer debtor proceeding, the reasoning of the court is along the same lines.

In **Columbia Aircraft Company v. United States**, 163 F. Supp. 932, Judge Learned Hand in a District Court decision held that the doctrine of the Saper case was applicable in an Arrangement case to the claim of the Government to set off its claim for interest against the debtor's claim for over-payment of taxes.

Another line of cases involves the Government's claim that where a tax lien had been perfected prior to bankruptcy, the doctrine of the Saper case is inapplicable. The courts have uniformly rejected this contention.

Simonson v. Granquist, 369 U. S. 38, 7 L. Ed. (2d) 557, 82 S. Ct. 537;

In re Cameron (D. C. Calif.), 166 F. Supp. 400, aff'd. 271 F. (2d) 129;

In re Young (D. C. Wisc.), 171 F. Supp. 317;

In re Kerber Packing Company (C. C. A. 7), 276 F. (2d) 245;

In re Industrial Machine & Supply Co. (D. C. Pa.), 112 F. Supp. 261.

In the Industrial Machine & Supply Co. case the court points out, as other decisions have done, that interest should not be allowed against funds held by an officer of the court since delay in distribution is an act of law and is a necessary incident in the administration of the estate.

There is some analogy between the situation before the Court and that which faced the courts in determining whether bondholders holding obligations which provided for interest, were entitled to have that interest run after bankruptcy, in accordance with the provisions of the bonds. Of course this question is well settled now, but at the outset the problem reached the Supreme Court of the United States, and it was held that a Bankruptcy Court as a court of equity had the power to determine how a debtor's assets should be distributed and that a court of bankruptcy sitting as a court of equity would not enforce the contractual obligation which provided for the running of interest.

Vanston Bondholders Protect. Com. v. Green, 329 U. S. 156, 91 L. Ed. 162, 67 S. Ct. 237.

The Government contended in its brief filed below* "that interest constitutes an integral part of a tax liability," and that taxes and resulting interest constitute a single liability. That may be true in some cases, but it is not an inexorable rule. There is responsible authority to the effect that penalties and interest are not taxes.

United States v. Mighell (C. C. A. 10), 273 F. (2d) 682;
United States v. Nelson (D. C. Ill.), 91 F. Supp. 557;
Penrose v. United States (D. C. Pa.), 18 F. Supp. 413;
Capital Bldg. & L. Asso. v. Commissioner, 23 B. T. A. 848.

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* Throughout this brief we are compelled to assume that the Government will in the main rely upon the authorities cited in its Eighth Circuit brief.

The Supreme Court in the Saper case did not recognize any such rule, nor is any such rule recognized in the many cases following the Saper case, such as

United States v. Harrington (C. C. A. 4), 269 F. (2d) 719;

In re Kerber Packing Company (C. C. A. 7), 276 F. (2d) 245.

A number of non-bankruptcy cases state that a penalty for non-payment of a tax is merged in the tax so that the two become a single liability, but that is not a rule in bankruptcy cases.

Bankruptcy Act, Sec. 57j, 11 U. S. C., § 93j;

In re Tom's Villa Rosa, Inc. (D. C. Conn.), 198 F. Supp. 137.

The real point we are dealing with here is whether there is any equitable ground for an exception to the general rule that post-bankruptcy interest is not allowable or payable out of the assets of the bankrupt estate.

D.

In determining whether interest on tax claims is allowable in bankruptcy proceedings, the provisions of the Bankruptcy Act rather than of the Internal Revenue Code govern.

The United States in support of its position has cited statutory provisions contained in 28 U. S. C., § 960, contending that they govern. It must be remembered that at the time of the Saper case there was in effect Section 3466 of the Revised Code of the United States, Comp. Stat., § 6372,* which gave the United States priority of the payment of tax claims in insolvency cases. It has been uniformly held that such a general provision of the Federal Law does not apply in bankruptcy, that to determine the

* See Appendix I.

rights of the parties including tax claimants we must look solely to the provisions of the Bankruptcy Act. In fact, that is the philosophy of the Saper case.

We note that 28 U. S. C. A., § 960, refers to "any officers and agents conducting any business under authority of a United States Court." We are also cognizant of the fact that there are decisions holding that the status of a debtor-in-possession is that of a trustee. But their positions are not exactly similar and should certainly appear dissimilar to a court of equity. Here the trustee did not operate a business. A trustee or a receiver operates under a bond, and is liable for his mistakes. A debtor-in-possession does not so operate, and his mistakes under appellant's theory would fall upon innocent parties.

The Saper case was decided as it was in spite of the provisions of the Internal Revenue Code of 1939 which governed the liability for taxes and provided that in case of delinquency the interest should be added as part of the tax (1939 Internal Revenue Code, §§ 3670, 3671).**

To consider further 28 U. S. C. A., § 960, we refer to a discussion of that section contained in **McColgan v. Maier Brewing Company** (C. C. A. 9), 134 F. (2d) 385. The decision points out that prior to the enactment of this section the law on the subject of the liability of court officers was in a choatic condition, and that this provision in the statute was not in terms or by implication intended to impair the principle that property in the custody of the Bankruptcy Court may not be subjected to liens while so held.

We submit that the purpose of the enactment of 28 U. S. C. A., § 124a, now designated as 28 U. S. C., § 960, was to fix the liability of officers of the court engaged in business, to require them to pay taxes as expenses of their operations or to assume a risk in the event of their failure

** See Appendices II and III.

so to do. The purpose of this enactment was not to penalize other creditors in the event of the failure of officers to perform their duties.

The holding in a New York District Court case, **In re Ten Eyck Co., Inc.**, 40 F. Supp. 270 stated:

> "Certainly it cannot be held that section 124a of Title 28 was intended to amend the Bankruptcy Act in any way or to prevail over it."

We have heretofore cited **State of Missouri v. Earhart** (C. C. A. 8), 111 F. (2d) 992,* which held that the court in classifying expenses of administration would be bound by the provisions of the Bankruptcy Act and not by the provisions of the Internal Revenue Code.

We have also referred to the case of **Davis v. Pringle**, 268 U. S. 315, 69 L. Ed. 974, 45 S. Ct. 549, decided some years prior to the Earhart case, a case in which the Government claimed that by reason of Section 3466 of the Revised Statutes, the United States had priority under Section 64a (5) over other creditors. At that time 64a (5) gave a fifth priority to:

> "Debts owing to any person who by the laws of the State or the United States is entitled to priority."

And it was argued that this section gave priority to the United States because of said Section 3466. It is extremely significant that this claim on the part of the Government was denied. (Since that time Section 64a (5) has been amended so as to include specifically the United States.) Justice Holmes in Davis v. Pringle based his finding upon **Guarantee Title & T. Co. v. Title Guaranty & S. Co.**, 224 U. S. 152, 56 L. Ed. 706, 32 S. Ct. 457, in which the court rejected the Government's claim that Section 3466 of the Revised Statutes established for the United States

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* Cert. den. 311 U. S. 676, 85 L. Ed. 435, 61 S. Ct. 43.

in bankruptcy proceedings a priority claimed by the United States.

We deny the contention of the United States argued below that under the decision of the lower courts the debtor-in-possession and the trustee would obtain an advantage over other businesses which is not sanctioned by Section 960 of 28 U. S. C. The Government in this case is seeking an advantage over other creditors holding cost-of-administration claims, because those creditors not only do not get interest on their claims, and, as we have pointed out, it is conceivable that the premature payment in full of the Government's claim would deprive other cost of administration creditors of money to which they are entitled; or if the Government's claim is not paid promptly, and interest is paid on it, this would give the Government interest where interest is not paid on other cost of administration claims.

The Government in its brief in the Eighth Circuit cited many cases of general application, interesting in themselves, but which do not touch upon the point at issue here. Some of them are non-bankruptcy cases. Most of them were decided prior to the Saper case, which in effect reversed holdings in many prior cases. Cited were such cases as **United States v. Killoren,** 119 F. (2d) 364, the rule of which was nullified by subsequent legislation. The Government also cited **Michigan v. Michigan Trust Company,** 286 U. S. 334, 76 L. Ed. 1136, 52 S. Ct. 512. This is not a bankruptcy case and all that it holds is that franchise taxes imposed by Michigan Statute must be paid as a cost of administration by an operating receiver incurring such taxes, that a claim for such taxes has priority over the claims of general creditors. We shall attempt to discuss only those cases which appear to have a direct bearing upon the problem here before this Court.

Boteler v. Ingels, 308 U. S. 57, 84 L. Ed. 78, 60 S. Ct. 29, involved a claim of the United States for a penalty im-

posed by state law for failure to pay license fees accruing during the operation of the bankrupt's business by a trustee in bankruptcy. The court held that since the penalty arose after the filing of the petition, Section 57j of the Bankruptcy Act (11 U. S. C., § 93j) had no application and that the state was not barred from collecting the penalty. The Boteler case was decided ten years before the Saper case and the court did not discuss the equities of the situation. **In re Chicago & N. W. Ry. Co.** (C. C. A. 7), 119 F. (2d) 971, decided in 1941, and **In re Flayton** (D. C. N. Y.), 42 F. Supp. 1002, decided in 1942, involving penalties, and **In re International Power Securities Corp.** (D. C. N. J.), 109 F. Supp. 544, decided in 1953, involving interest, followed the Boteler case. It does not appear to us that in any one of these cases the amount of the liability fell upon innocent creditors, and in none of them did the court discuss the equities of the situation. The Saper case was decided in 1949.

The Government also relied upon **Bruning v. United States**, 376 U. S. 358, 11 L. Ed. (2d) 772, 84 S. Ct. 906. The Bruning case did not involve the liability of the estate but of a debtor for post-petition interest. It was not concerned with payment out of the funds of an estate, and in its decision the Court stated:

> "The basic reasons for the rule denying post-petition interest as a claim against the bankruptcy estate are the avoidance of unfairness as between competing creditors and the avoidance of administrative inconvenience."

The Government in discussing the Bruning case assumed that the language quoted above does not apply to the facts of this case. With that we disagree. Government's counsel assumed that taxes constitute a first priority and can be paid forthwith. For reasons we have stated elsewhere, taxes are not a first priority under the 1952 amendment to Section 64a (1) of the Bankruptcy

Act [11 U. S. C. 104a (1)], and in addition, must share pro-rata with other costs of administration.

And then there is **In re Airline-Arista Printing Corp.** (D. C. N. Y.), 156 F. Supp. 403.* In this Chapter XI case the debtor-in-possession was ordered to segregate amounts withheld from the wages of employees and to place these amounts in a special fund. The debtor-in-possession failed to comply with the court order. The court found (l. c. 404) that "At all times the debtor-in-possession had assets of a greater value than the amount of the taxes which it had withheld and these assets came into the hands of the trustee." The intermingling of such amounts with the general funds of the debtor-in-possession was not only wrongful under the Internal Revenue Code but contrary to the specific order of the court and the funds so withheld constituted the corpus of a trust. **The Airline-Arista case did not involve the payment of interest.** All that it held was that the Government had succeeded in tracing the corpus of a trust consisting of money withheld from the wages of employees, that therefore the Government was entitled to it, and that the provisions of the 1952 amendment to Section 64a (1) therefore did not apply.

E.

The claim of the United States for interest cannot be sustained on the theory of a trust since the Trustee in Bankruptcy acquired no trust funds.

It is not essential to the decision in this case to determine whether the principal amount of the Government's claim, i. e., its claim for the amount of the withholding taxes, were subject to a trust, whether or not the funds could be traced. But interest cannot be held subject to a trust because the interest was never in existence, and a

* Aff'd 267 F. (2d) 333.

trust cannot exist where there never was a corpus of the trust estate.

Restatement of the Law of Trusts (2d), § 202, Ch. 7, p. 451;

Restatement of the Law of Restitution, § 215, Ch. 13, p. 866;

Scott on Trusts (2d ed.), Vol. IV, p. 3325, § 52;

Bogert, "Trusts and Trustees" (2d ed.), § 921, Ch. 44, pp. 303-305.

For a cestui to recover from a fund on hand, he must trace into that fund:

Macey v. Roedenbeck (C. C. A. 8), 227 Fed. 346;

Mechanics & Metals Nat. Bank v. Buchanan (C. C. A. 8), 12 F. (2d) 891;

Farmers' Nat. Bank v. Pribble (C. C. A. 8), 15 F. (2d) 175;

Dudley v. Richards (C. C. A. 8), 18 F. (2d) 876;

Hanna v. Consolidated School Dist. No. 1 (C. C. A. 8), 78 F. (2d) 374.

The above decisions are in conformity with decisions of the Supreme Court. Mr. Justice Cardozo in a 1935 opinion used the following language: " • • • The money so returned is then subjected to a trust and though mingled with other money is viewed as retaining its identity so long as any portion of the fund is discovered to be intact. These fictions and presumptions • • • will not be so applied as to impose a trust relation upon moneys that have entered into 'the stream of the firm's general property' (cases cited) and are distinguishable no longer."

Adams v. Champion, 294 U. S. 231, 238, 79 L. Ed. 880, 884, 55 S. Ct. 399.

Two years later this Court reaffirmed the rule of Adams v. Champion, citing the following excerpt from 294 U. S., l. c. 239:

"Evidence is lacking that it (wrongful withdrawal) was withdrawn in such a form or for such purposes as to be represented by any assets forming part of the estate today."

Hoffman v. Rauch, 300 U. S. 255, 258, 81 L. Ed. 629, 631, 57 S. Ct. 446.

It is an abuse of language to describe an obligation, no matter how important it may be, as a trust obligation where there is no trust. The fact that there should be a trust does not miraculously create one when there is none. Wishing cannot make it so and only leads to bad law.

F.

Section 378 of the Bankruptcy Act has no application to the situation here before the court.

The Government has contended that in a situation where an adjudication follows a Chapter XI operation by a debtor in possession, the provisions of Section 378 of the Bankruptcy Act (11 U. S. C., § 778) require that the proceedings be conducted as far as possible as if an order of adjudication had been entered on the day when the petition was originally filed. We are not convinced that under the circumstances of this case that Section 378 is applicable. It does not require that in every instance the proceedings be conducted as if there had been an adjudication on the date of filing but only that this be done "so far as possible." It is difficult to see how the court can hold that Section 378 is applicable to something that did not begin to happen until after the date of filing. Under the 1952 amendment to Section 64a (1) expenses of liquidation must first be paid, as we have heretofore shown.

But even if this were true, the reasoning and logic of the Saper case and of the other cases that we have cited seem to apply. There is no valid or logical reason why a court of equity should hold that 28 U. S. C. A., § 960 has any

greater application to an operation under the Bankruptcy Act after adjudication than Sections 3670 and 3671 of the 1939 Internal Revenue Code and Section 3466 of the Revised Statutes had to an operation prior to adjudication.

V.

CONCLUSION

The equitable considerations which impelled the Supreme Court in the Saper case to protect the interest of creditors are just as applicable to the creditors in this case as in the Saper case. If it was inequitable to take interest from funds in custodia legis for the benefit of one creditor and to the detriment of others, as the Supreme Court found it was in the Saper case, it is just as inequitable in the case here before the Court.

Respectfully submitted,

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Attorney for Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt, Respondent in Cause 711, October Term, 1965, Amicus Curiae.

APPENDIX I.

Section 3466 of the Revised Statutes of the United States:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

APPENDIX II.

Section 3670 of the 1939 Revenue Act:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or additional to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

APPENDIX III.

Section 3671 of the 1939 Revenue Act:

"Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."

FEB 2 81
JOHN F. DAVIS

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 650

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEAL FOR THE FIFTH CIRCUIT

PETITIONER'S BRIEF ON THE MERITS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 650

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEAL FOR THE FIFTH CIRCUIT

PETITIONER'S BRIEF ON THE MERITS

February 1966

OPINIONS BELOW

The Opinion under review is that of the Court of Appeals for the Fifth Circuit in United States of America vs. John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, 346 F(2) 32(May 25, 1965), contained in the Transcript of Record (hereinafter designated "R"), at page 33. This decision was on an appeal from an Order of the District Court (R 25) affirming an Order of the Referee in Bankruptcy (R 19). There were no formal opinions by either the Referee or the District Judge.

JURISDICTION

The judgment before the Court for review was entered by the Court of Appeals for the Fifth Circuit on May 25, 1965. A Petition for Rehearing was filed on June 23, 1965, and an Order denying the Petition for Rehearing was entered on July 9, 1965. The Petition for Certiorari was filed with this Court on October 6, 1965. The jurisdiction of this Court rests on 27 U.S.C. § 1254, sub-section (1), and, also, Supreme Court Rule 19.1(b) which permits certiorari to courts of appeal where there is a conflict of opinion between the various circuit courts of appeal.

Jurisdiction of this Court is also based on 11 U.S.C., § 47(c); § 24(c) of the Bankruptcy Act, as Amended.

STATUTES INVOLVED

The Statutes and Regulations germane to consideration of this matter are listed below, and their full text is set out in Appendix A.

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A. The Acts of Congress Relating to Bankruptcy:

11 U.S.C. § 75(a) (Sec. 47a-Bankruptcy Act) Trustees; duties. 1

11 U.S.C. § 104 (Sec. 64 Bankruptcy Act) Debts which have priority 2

11 U.S.C. § 778 (Sec. 378 Bankruptcy Act) Procedure upon order directing that bankruptcy be proceeded with 5

B. The Internal Revenue Code of 1954:

26 U.S.C. § 3504, Acts to be performed by agents. 6

26 U.S.C. § 4231(6), Cabarets. 7

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QUESTIONS PRESENTED

1. WHETHER THE RULE THAT CLAIMS IN LIQUIDATING BANKRUPTCY DO NOT DRAW INTEREST IS ALTERED BECAUSE THE CLAIM WAS FOR TAXES INCURRED BY A DEBTOR IN POSSESSION IN A BANKRUPTCY ACT CHAPTER XI DEBTOR RELIEF PROCEEDING THAT PRECEDED THE ADJUDICATION AND LIQUIDATION.

2. WHETHER A TRUSTEE IN BANKRUPTCY IS LIABLE FOR PENALTIES FOR FAILURE TO FILE TAX RETURNS FOR CABARET EXCISE TAX, FUTA, FICA AND WITHHOLDING TAXES WHEN THE TAXES WERE THE LIABILITIES OF A PREDECESSOR DEBTOR IN POSSESSION DOING BUSINESS UNDER A CHAPTER XI PROCEEDING OF THE BANKRUPTCY ACT.

STATEMENT OF THE CASE

On August 6, 1958, Beachcomber Motel, Inc. filed a voluntary Petition for Arrangement with its unsecured creditors, under Chapter XI of the Bankruptcy Act, 11 U.S.C., § 722, Bankruptcy Act § 322 (R. 1). On September 17, 1958, the corporation, having failed to present a Plan acceptable to its creditors, was adjudicated a bankrupt- (R 37). Between the filing date and the date of adjudication, September 17, 1958, Beachcomber Motel, Inc. had operated its motel business as a Debtor in Possession under authority of the Bankruptcy Court.

The United States filed a claim for taxes in the subsequent liquidating bankruptcy proceedings (R 9). The claim included pre-petition taxes that had accrued prior to August 6, 1958, the date of the filing of the Chapter XI petition and, also, a claim for taxes described as "administrative expense taxes." The "administrative expense taxes," were for taxes incurred by the Debtor in Possession between the date of the filing of the Petition for Arrangement and that of the entry of the order of adjudication, on September 17, 1958. Petitioner Trustee does not deny his obligation to pay the pre-petition taxes as a priority claim under Section 64(a)(4) of the Bankruptcy Act, nor his obligation to pay that portion of the "administrative expense taxes" representing the principal portion of the tax obligations incurred by the Debtor in Possession, as a cost of administration, under Section 64(a)(1), of the Act.

The Trustee objected to the portion of the claim of the Government which requested payment, from the bankrupt estate, as part of the Government's administrative claim under Section 64(a)(1) of the Act, post-adjudication interest and penalties on the "administrative expense taxes" incurred by the Debtor in Possession (R 10, 11). The Debtor in Possession incurred administrative tax liability to the United States of $519.89 for withholding and Federal Insurance Compensation Act (FICA) taxes; $644.00 for cabaret or excise taxes; and $362.29 for Federal Unemployment Tax (FUTA) taxes. The Government claimed, as part of its administrative claim under Section 64(a)(1), these amounts, and assessed interest, and accrued interest on each of these taxes. The FICA taxes and interest were assessed on February 2, 1962; the excise taxes and interest were assessed on April 14, 1959, and

the FUTA taxes were assessed on April 14, 1959. Accrued interest was claimed from date of assessment to date of filing of the claim, which was April 11, 1963, and, also, the claim requested liability for interest on the entire principal amount from April 11, 1963, to date of payment.

The claim also requested assessed penalties for alleged failure of the trustee in bankruptcy to file tax returns for the Debtor in Possession in the three areas of tax liability.

The Referee in Bankruptcy sustained the objection and denied the Government's demand for interest to date of payment, accrued interest and penalties, and allowed as an administrative expense the principal balance of the three taxes and the assessed interest thereon (R 12, 13).

The Government filed a petition for review to the United States District Court from the order of disallowance of the penalties and accrued interest (R 14, 15).

The District Court affirmed the Order of the Referee (R 16).

On appeal by the United States, the Court of Appeals for the Fifth Circuit reversed and allowed the penalties, accrued interest, and interest to date of payment, and penalties for failure to file returns, all as costs of administration, in the liquidating bankruptcy (R 21).

ARGUMENT

POINT I

CONGRESS HAS PROVIDED AN ORDERLY, EQUITABLE DISTRIBUTION OF BANKRUPT ESTATES BY ESTABLISHMENT OF SPECIFIC PRIORITIES, AND A DEPARTURE FROM THE PRECISE PLAN SHOULD BE AVOIDED.

The plan established by Congress in the Bankruptcy Act for an orderly distribution of assets from liquidating bankruptcies has been strictly observed and deviations therefrom have not been judicially favored. The Government's claim in the estate of Beachcomber Motel, Inc. is accorded a specific priority under § 64(a)(1) of the Bankruptcy Act as a cost of administration. The effect of the instant decision of the Fifth Circuit is to grant to the Government a position superior to that specifically provided in the Bankruptcy Act. The decision creates a super-priority requiring either premature payment of the Government's claim, or the exaction of a unique and unprecedented accumulation of interest until the date of payment of claim, completely alien to the Government's clearly established position on the well defined ladder of priorities.

The Court of Appeals for the Eight Circuit, in **United States v. Kalishman,** (CA 8 1965) 346 F(2)514, decided June 4, 1965, considered the same problem and reached an opposite conclusion. The Eighth Circuit rejected the Government's contention that interest on unpaid withholding taxes should be a continuing obligation of a trust-

ee in liquidating bankruptcy merely because the taxes were incurred by a debtor in possession in a debtor relief proceeding under Chapter XI of the Bankruptcy Act.

All costs of administration incurred during the operation of a debtor in possession are on a parity. The claim of the sovereign has no priority over other costs of administration and distribution to the Government must be in accordance with the statutory plan provided by Congress. This rule is well recognized in situations where straight bankruptcy liquidation follows a Chapter XI arrangement proceedings, as in the instant matter. See **State of Missouri v. Earhart** (CCA 8, 1940) 111F(2) 922.

The purpose of bankruptcy proceedings is to collect the assets of the debtor and equitably distribute them to the creditors, in accordance with the priorities prescribed in the Bankruptcy Act. **Guarantee Title & T. Co. v. Title Guaranty & S. Co.**, 224 U.S. 152, 56 L. Ed. 706, 32 S. Ct. 457, held that § 3466 of the Revised Statutes, now 26 U.S. Code, § 960, the insolvency statute, would not prevail over the specific provisions of the Bankruptcy Act. In the **Guarantee Title** case, this Court held that wage claims allowed a second priority under Section 64 of the Bankruptcy Act prevailed over taxes, accorded a fourth priority.

In **Davis v. Pringle**, 268 U. S. 315, 45 S. Ct. 549, 69 L.Ed. 974, another attempt by the Government to invoke the provisions of § 3466 of the Revised Statutes was rejected by this Court. The reasoning of **Davis v. Pringle** is still applicable, although the statute has been amended to effectuate the Government's contentions in that case.

In **Matter of Connecticut Motor Lines**, 336 F(2) 96 (CCA 3, 1964), the Third Circuit thoroughly considered the meaning and intent of the priority section of the Bankruptcy Act, § 64(a), and the status of claims for withholding and FICA taxes arising from wages due prior to the bankruptcy, but paid during the bankruptcy. The Court followed the applicable legislative intent to uphold the provisions of the Bankruptcy Act and strictly applied the priorities provided.

Necessary to the orderly administration of the Bankruptcy Act is observance of the axiom that even revenue producing statutes must necessarily be interpreted in contemplation of the Bankruptcy Act and bankruptcy statutes must prevail.

United States v. Speers, 86 S. Ct. 411 (1965) _____ U.S._____ is the most recent illustration of this Court's application of this rule in its consideration of the relation of § 70 of the Act, 11 U.S.C., § 110, and 26 U.S.C. § 6323 of the Internal Revenue Code. The Court held that there was no conflict in the two statutes but the congressional intent in the Bankruptcy Act is accredited its full and complete meaning without reservations, notwithstanding an enactment by the Internal Revenue Code on the same subject matter.

If the intent of Congress, as expressed in its establishment of priorities in Section 64 of the Bankruptcy Act, is to be followed, then distributions must be made in express compliance with those priorities, unless there is a clear expression of legislative intent to the contrary. General tax revenue statutes have not been recognized as furnishing a basis for altering the Bankruptcy Act's

prescribed outline of distribution. The allowance of post-adjudication interest on a tax claim would constitute such an alteration and should not be permitted.

This Court recognized the inter-relations of the revenue statutes and the Bankruptcy Act in **City of New York v. Saper**, 336 U.S. 328, 69 S. Ct. 554, 93 L. Ed. 710 (1949), The Court succinctly stated its position with the observation:

> "We do not believe the Revenue Act of 1924 and similar enactments were intended to amend the comprehensive scheme of the Bankruptcy Act."

The **Saper** case involved taxes due prior to commencement of a bankruptcy proceeding, unlike the taxes under consideration here.

This is not a distinguishing feature. The controlling similarity of this proceeding with that in the **Saper** case is that in both situations the Court deals with liquidating bankruptcies under Chapters I through VII of the Act and the rationale of **Saper** is as much applicable here as it was in the proceedings then before the court. Adaptation of the rule of the **Saper** case by the various courts of appeal is found in **Adams v. O'Malley** (CA 8, 1950) 182 F(2) 925; **United States v. Bradley** (CA 5 1963) 321 F(2) 224, and **In Re Connecticut Motor Lines**, supra;

Frequently, operations by a debtor in possession are unsuccessful, and it cannot be determined until final meeting whether there will be enough on hand to pay costs of administration claims in full. If the strict priorities prescribed by the Bankruptcy Act are not followed and

their prescriptions can be abrogated by awards of continuing interest, as the ruling of the Fifth Circuit has allowed, the Trustee, with an estate insufficient to satisfy all priority obligations, and attempting to allocate funds to pay the claims and cost of administration expenses, is inevitably faced with a dilemma. If the Trustee is required to pay one or more of the costs of administration claims in full, and then it turns out that there are insufficient funds to pay all of such parity claims, some of such creditors have been treated unfairly, and the Trustee will be liable on his bond. The situation in **United States v. State of New York**, 315 U.S. 510, 62 S. Ct. 712 (1942) was an example of an estate with insufficient assets to pay all of the § 64(a)(1) priority claims.

To delay payment and incur interest as required by the ruling of the Fifth Circuit, may result in a diminution of the dividend payable on claims of equal dignity and certainly penalizes claims of inferior dignity. The principle of forcing premature payment of **certain** taxes under penalty of incurring an obligation to pay post-adjudication interest is not only completely alien to ordinary bankruptcy procedures and their statutory bases, but is inequitable to creditors and, Petitioners contends, is without legal foundation or precedent. The arguments which support the requirement that interest be paid on taxes to force timely payment is absent in these circumstances. Admittedly, the imposition of interest is a logical requirement to motivate the taxpayer to pay taxes. The need for such motivation is not applicable to a liquidating bankruptcy procedure under Chapters I through VII of the Act.

POINT II

ALLOWANCE OF POST BANKRUPTCY INTEREST ON TAX CLAIMS IS INEQUITABLE TO OTHER CREDITORS AND ADMINISTRATIVELY BURDENSOME.

City of New York v. Saper, supra, establishes the rule from which Petitioner contends the Fifth Circuit has departed: Post-petition interest is not allowable on claims, whether for taxes, or otherwise. The Saper decision dealt with interest on taxes that accrued prior to the bankruptcy proceeding, as contrasted with interest on taxes accruing prior to adjudication as in the instant facts. The controlling similarity of this proceeding with that in the Saper case is that in both situations the Court deals with the award of interest accruing during a liquidating bankruptcy. The rationale of the Saper case is equally applicable here. The rationale of the Saper case is that it is inequitable to allow interest to the Government on funds while those funds are in the hands of a trustee in bankruptcy. The Court pointed out that to allow such interest would grant the Government preferred treatment over other claimants of equal priority and there was nothing in the law which justified the conclusion that Congress intended to give the Government such preferred treatment. Saper recognizes the principle that liquidation of estates in bankruptcy requires that continuing obligations must cease at some point and the amounts of claims be determined for the fixing of priorities and for distribution. Sound administration and calculation of dividents is otherwise impossible. 3 Collier on Bankruptcy, 14th Ed. § 63.16(2). Saper was followed by United States v. Edens, 342 U.S. 912, 96 L. Ed 682, 72 S. Ct. 357, and

United States v. General Engineering & Manufacturing Co., 342 U.S. 912, 96 L. Ed. 682, 72 S. Ct. 358. **United States v. Edens**, supra, is a decision affirming a Fourth Circuit decision reported at 189 F(2) 876, in which the Court of Appeals recognized the inequity of allowing interest on tax claims and applied this rule to reorganization proceedings, as well as to straight bankruptcy proceedings. The Court stated that no single class of creditors should be able to benefit at the expense of another class of creditors, particularly when any delay in payment of claims was caused by application of an Act of Congress and not by the dilatory activities of the taxpayer. This opinion rebuffs the Government's instant contention that its claim should be paid prior to general distribution and that interest should be approved as a penalty for that nonpayment. If the Government prevails in its position, it is not the Trustee who is penalized for non-payment, but it is the other creditors, who have no control as to the date of payment of taxes. The inequitable and impractical effect of requiring interest on certain claims in bankruptcy proceedings, whether in reorganization poceedings or straight bankruptcy, is well accepted and has received consistent recognition in all of the Federal decisions since the **Saper** case. The Fourth Circuit, in **United States v. Harrington**, 269 F(2) 719, recognized the rule against post-petition interest on tax claims in order to prevent inequities, and the penalizing of other creditors because of that interest payment. Recently, the reasoning of this Court in the **Saper** case was reasserted in **Smith v. Robinson** (CA 4, 1965), 343 F(2) 793, in which post-petition interest on claims in a Chapter X proceeding was denied.

In **Vanston Bondholders Protect. Com. v. Green**, 329

U.S. 156, 91 L. Ed. 162, 67 S. Ct. 237, certain bondholders were denied interest, notwithstanding their contractual obligation, because of the inequitable result of denying such interest payments to other creditors with claims of equal dignity. The logic of the **Saper** case, supra, is plain and persuasive. In **State of New York v. Feinberg**, (CCA 2), 204 F(3) 502, the Court of Appeals considered a Chapter X proceeding in which the State objected to a plan of reorganization providing for issuance of bonds to pay the State's claim for taxes when such bonds carried interest at a rate lower than that provided by New York law. The rationale of the opinion, denying the State's claim, was that the state is not entitled to post-petition interest on its claim in any event and, therefore, could not be heard to complain as to the rate of interest set by a Plan.

The rationale of **Saper, Vanston Bondholders**, and the other authorities supporting the refusal of post-adjudication interest on claims in bankruptcy, coupled with the recognition of the administrative burden of calculating such interest, persuaded the Referee and the District Judge to deny post-adjudication interest in the matter at hand. These considerations were recognized by the Court of Appeals for the Eighth Circuit in the **Kalishman** case, supra, which is in direct conflict with the decision on review here.

The only distinguishing feature the Fifth Circuit finds in the facts at hand from those in the **Saper** case, supra, is that in the facts at hand, the liquidating bankruptcy administration superseded Chapter XI arrangement proceedings.

The effect of the rule imposed by the Fifth Circuit in this Opinion, in conflict with the **Kalishman** decision, is that the Trustee in liquidating bankruptcy must pay, prematurely, and out of turn, claims for taxes which are even inferior in dignity to the expenses of the bankruptcy administration itself, as provided in § 64(a)(1) of the Act. The alternative, is to incur a continuing obligation of interest to be paid out of the estate to the prejudice of other creditors, some of whom are on equal priority status as the claim of the Government.

The Government's claim in the instant matter, as an "expense of administration" was accorded Class 1 priority under § 64 of the Bankruptcy Act. It is limited only by the fact that it is an expense of a superseded debtor relief proceeding. That fact, by the express language of § 64, subordinates this claim to the expenses of the administration necessary for the liquidation of the bankrupt estate

The taxes under consideration here, Withholding, FICA, FUTA and cabaret excise, became returnable at a time after the termination of the Chapter XI Debtor in Possession administration and during the period of administration of the liquidating trustee in bankruptcy.

If interest is permitted on the taxes from the date they are returnable, notwithstanding the fact that it is a date within the administration of a liquidating bankruptcy, the trustee is then faced with a dilemma. Payment of taxes prematurely by the Trustee may be at the peril of reducing his estate and not having sufficient assets to pay administration expenses superior to the tax claim.

Saper, Kalishman and other authorities disallowing interest, recognize that the persuasive reasons for interest accruing on unpaid principal of taxes is absent in a liquidating bankruptcy proceeding. If the entity incurring liability continues to exist and operate, imposition of interest is a logical requirement to persuade such continuing entity to pay its taxes. By way of example, the liability surviving bankruptcy for non-dischargeable taxes, the liability of a continuing trustee in bankruptcy receivership proceedings are reasonable subjects for interest imposition. The distinguishing features between the allowance of post-petition interest on entities other than a liquidating bankruptcy trustee was recognized by this court in **Bruning v. United States,** 376 U.S. 358, 11 L. Ed. (2) 772, 84 S. Ct. 906. There, the court allowed post-petition **interest** on a continuing obligation of a debtor inasmuch as taxes are non-dischargeable in bankruptcy. The court specifically acknowledged the logic and persuasiveness of the **Saper** ruling in the liquidating trustee situation. **Boetler v. Ingels,** 308 U.S. 57, 84 L. Ed. 78, 60 S. Ct. 29, is another instance where penalties were allowed on taxes but such allowance was against an operating trustee. The operating trustee failed to obtain a license to continue his business and the penalties were upheld during the continuing administration. Not considered, however, was the imposition of the penalties on a later liquidating bankruptcy proceeding. The Fifth Circuit opinion in this case (R 33) cited **Boetler v. Ingels,** supra, as authority for the imposition of interest and penalties on the liquidating trustee in this particular case. The opinion, however, does not recognize the distinguishing nature of the liquidating bankruptcy procedure as opposed to the continuing entity of a Chapter XI debtor in possession or a trustee or receiver. This distinction was

specificall yrecognized by this Court in **Bruning v. United States**, supra.

The motivation to pay taxes created by the imposition of interest on the principal amount is absent in its application to trustees in liquidating bankruptcy estates. The straight bankruptcy trustee has a specific duty under the law to gather the assets and allot to the government its proper statutory priority. All of these activities are under the supervision of the court, to which the government has access to compel the trustee to more expeditious activity if there is a delay unwarranted by the circumstances.

The distinguishing nature of the liquidating straight bankruptcy in contrast to the continuing trustee operating a business or other continuing entity raises another problem not acknowledged by the Fifth Circuit in the opinion entered in this cause.

The trustee in bankruptcy is required under the duties contained in the Act to collect the assets of the debtor and then make equitable distribution in pro rata shares recognizing the scale of priorities set out in the Act.

To properly carry out this responsibility, it follows that liability on the various claims must at some point cease and allocation of shares take place.

This principle is fundamental in liquidating bankruptcies and there is no reason that it should not be applicable to a liquidating bankruptcy that succeed an unsuccessful debtor relief proceedings. The rule estab-

lished by the Fifth Circuit in this instance singles out this one exception and ignores the compelling practical problems inherent in the ruling which will necessarily complicate conclusion of such superseded bankruptcy proceedings. See 3 Collier on Bankruptcy, page 1855.

POINT III

THE BANKRUPTCY ACT, § 378(2) IS NOT AN EXPANSION OF THE LIABILITIES AND DUTIES OF A TRUSTEE IN LIQUIDATING BANKRUPTCY BUT MERELY A DEFINITION OF THE TIME FROM WHICH THE TRUSTEE'S RIGHTS ACCRUE.

The original petition of the Debtor, Beachcomber Motel, Inc. was under Chapter XI of the Bankruptcy Act, so when straight bankruptcy was ordered Section 378, sub-section (2) was activated rather than sub-section (1). The pertinent portion of sub-section 2 reads as follows:

> "(2) in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed;"

The Court of Appeals for the Fifth Circuit in these proceedings, and the Court of Appeals for the Eight Circuit both considered the application of § 378(2) with

respect to the charge by the Government that the trustee in liquidating bankruptcy is responsible for interest on tax liabilities of his predecessor debtor in possession. The Fifth Circuit has interpreted § 378 as imposing an expansion of the duties of a trustee in liquidating bankruptcy.

The effect of the holding of the Fifth Circuit in this proceeding is that a debtor in possession and its successor trustee in liquidating bankruptcy is one administration and liabilities and obligations of the debtor in possession conducting a business become the liabilities and obligations of the liquidating trustee. The decision of the Fifth Circuit ignores the existing legislation in the direction of Section 64(a)(1) of the Bankruptcy Act that the expenses of administration of a liquidating bankruptcy are to be paid in full prior to the payment of the obligations of a debtor relief proceeding. Thus, the straight bankruptcy trustee, succeeding to any Chapter XI proceeding, cannot evaluate his liabilities and duties by the traditional obligations of a trustee under Chapters I through VII of the Act but he must inquire into and shoulder the responsibilities of his predecessor notwithstanding the different nature of the two proceedings.

An examination of § 378 in the context of the entire Chapter XI of the Act demonstrates that it is designed to implement the transition from an active debtor relief proceeding into a straight bankruptcy under Chapters I through VII of the Act.

This section defines the time when the rights of the trustee in bankruptcy accrue and relates them back to the time of the original petition under Chapter XI.

H.R. Report No. 17-245, 55th Congress, 2nd Session, 1897-1898; H.R. Report 1042, 75th Congress, 1st Session, 1938.

The function performed by § 378 of the Bankruptcy Act is the solution of the problem of whether the trustee in bankruptcy succeeds to propery rights as of the date of adjudication, or as of the date of the filing of the original petition under the debtor relief proceeding. In **Miller v. Wooley** (CA 9, 1944) 141 F(2) 837, and **Wood v. Scott** (CA 6, 1950) 180 F(2) 252, the effect of §378 is described as a retroactive adjudication in bankruptcy following the interpretation that § 378 is nothing more than a relation of the time when the rights of the trustee accrue.

Such a determination is necessary since in numerous places in the Bankruptcy Act, the rights of the trustee are defined with respect to designated periods of time in relation to the date of the Petition.

The pinpointing of a fixed time with respect to determination of priorities is necessary as determined in Section 64 where priorities are allowed wage claimants for a period of three months and rent for a three month period and Section 60 (11 U.S.C. §96), as to preferences and Section 67 (11 U.S.C. §107) as to fraudulent conveyances, all relate to a set period of time in reference to the filing of the Petition. Again, in §70 (11 U.S.C. § 110), the filing of the Petition is important for determining the rights and title of the Trustee in property of the bankrupt.

Two significant propositions should be considered in the application of §378. The first, is that §378 by its

own terms is not mandatory, but requires that the proceedings after adjudication should be conducted, "so far as possible" as if the original petition for adjudication had been filed at the time that the debtor relief petition was filed. Secondly, it is certainly a revolutionary expansion of the duties of the trustee required by §47 of the Act (App. 1) to impose on the liquidating trustee, the responsibility for the conduct of the operating debtor in possession, including liabilities for continuing interest that would have been the obligation of the debtor in possession had it continued to operate the business.

Additionally, it is unnatural to identify the trustee with the debtor in possession. Identity of the two entities should not be attributed because of a similarity of powers. It is an unfair imposition of responsibility on the creditors' representative whose very election is often the result of heated antagonism with the debtor in possession and the result of disenchantment by the creditors with the debtor's conduct.

In this instance, the interpretation of §378 by the Fifth Circuit disrupts the entire scheme of priorities elaborately developed in §64 of the Act. The analysis supporting the rule denying post-petition interest established in **City of New York v. Saper**, supra, and other authorities that followed **Saper**, is abandoned by the novel view accepted by the Fifth Circuit in this proceeding.

The expansion of the scope of §378 of the Bankruptcy Act beyond the mere fixing of the date from which the trustee's rights accrue in his administration of a liquidating bankruptcy, is unwarranted by the language of that

Section and inconsistent with the reasonable and orderly administration of the Act.

POINT IV.

THERE IS NO DUTY IMPOSED BY THE INTERNAL REVENUE STATUTES ON LIQUIDATING TRUSTEES IN BANKRUPTCY TO FILE WITHHOLDING-FICA, FUTA AND CABARET TAX RETURNS ON BEHALF OF A PREDECESSOR DEBTOR IN POSSESSION.

The tax return requirement contained in the opinion of the Fifth Circuit, to which this Petition for Certiorari is directed, imposes on a trustee in bankruptcy a duty to file on behalf of a predecessor debtor in possession, tax returns for the debtor in possession for withholding taxes, excise taxes, FUTA and FICA taxes.

There is no duty imposed on a trustee in bankruptcy, by the revenue statutes which require the filing of these tax returns, for an entity and operation other than his own.

The portion of the Internal Revenue Code requiring the filing of returns for cabaret taxes is contained in 26 U.S.C.A., §4231, sub-section 6 (App.).

Returns for Withholding taxes, FICA and FUTA taxes are required in 26 U.S.C.A., §6011 (App. 7)

Congress does not impose the responsibility of filing the returns for these taxes on any person other than the person receiving the income or collecting the revenue.

In the facts before the Fifth Circuit concerning the Beachcomber Motel, Inc., the person receiving the income of collecting the revenue, of course, was the debtor in possession under the Chapter XI proceeding. If the debtor in possession administration had continued to the date when the returns were due, it would have been its officers' duty to file the returns and pay the tax as it would have been an entity with a continuing responsibility under the rule of **Boetler v. Ingels**, supra.

Likewise, if the Trustee had conducted the business and incurred tax liability for the various taxes involved here, it would have been his responsibility to file returns by the direct requirement of 28 U.S.C., §960 (App.).

The latter Section limited its application to trustees "conducting a business". There is, of course, no showing that the Trustee in Bankruptcy conducted a business in the process of liquidating the estate of Beachcomber Motel, Inc.

In fact, the arrangement failed and an adjudication was entered and the Debtor in Possession was dispossessed and the motel operation closed.

The intent and meaning of 28 U.S.C., §960, has been thoroughly considered by the Ninth Circuit in **California Board of Equalization v. Goggin**, 191 F(2)726 (CA 9, 1951), 27 A.L.R (2nd) 1211, (cert. den.) 342 U.S. 909, 72 S. Ct. 302, 96 L. Ed. 680, and, also, **California Board of Equalization v. Goggin**, 245 F(2) 44 (CA 9, 1957) (cert. den. 353 U.S. 961 77 S. Ct. 863 1 L. Ed. 2910). In the 1951 case, the trustee in bankruptcy succeeded a Chapter XI proceeding and made sales as trustee. Thereafter, a liquidation order was entered by the court and a sale was concluded

pursuant to it. Sales taxes were paid on the Chapter XI sales and, also, on subsequent sales made as trustee, but not on the final liquidation sale as ordered by the court. The liquidation sale was considered to have been an act not in the conduct of a business and, therefore, the trustee was not liable for taxes under the requirement of 28 U.S.C., §960.

The 1957 opinion again considered 28 U.S.C. §960 with almost identical circumstances and the court again drew the exact distinction between sales "in the conduct of any business", and the sales in the liquidation of the bankrupt estate pursuant to court order.

Petitioner contends that the same distinction recognized by the Ninth Circuit applies to the liquidating bankruptcy in this proceeding. The trustee in straight bankruptcy, liquidating a business that never operated under his control, is not bound by the provisions of 28 U.S.C., §960.

An example of the direct congressional enactment imposing on a trustee the obligation to file returns for a predecessor is contained in 28 U.S.C. §6012 (App. 8). This Section, of course, applies only to income taxes. No comparable provision has been found in the internal revenue statutes as to Withholding, FICA, FUTA or the cabaret taxes under consideration in this proceeding.

It then follows that the penalties claimed by the government for failure to file tax returns should not have been upheld by the Fifth Circuit as there is no statutory authority requiring the filing of those returns by the liquidating trustee in bankruptcy and they are certainly not listed as one of the duties under §47 (11 U.S.C. §) of the Act. (App. 1)

CONCLUSION

Petitioner, JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, submits that the Court should adhere to the rule of City of New York v. Saper and deny interest on claims in liquidating bankruptcy.

The equitable and practical basis for denial of interest in liquidating bankruptcy is present whether the claim arose prior to the original Petition or during the administration of a debtor in possession under a debtor relief proceeding.

Further, the requirement by the holding of the Fifth Circuit in this proceeding that a trustee in bankruptcy is responsible to file tax returns for Withholding-FICA, FUTA and Excise tax for revenue collected by a Chapter XI debtor in possession is not required by existing legislation and should be excused.

The judgment of the Fifth Circuit should be reversed and the Order of the District Court should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, JOHN H. GUNN, Attorney for JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankruptcy, Petitioner, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the_____day of February, 1966, I served copies of the foregoing PETITIONER'S BRIEF ON THE MERITS by mail, by depositing the same in a United States mail box, with first class postage prepaid, addressed to counsel of record at their post office addresses, as follows:

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APPENDIX

The Statutes and Regulations necessary for consideration of the issues involved.

11 U.S.C. §75(a) (Sec. 47a Bankruptcy Act) Trustees; duties.

> (a) Trustees shall (1) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estates as expeditiously as is compatible with the best interests of the parties in interest; (2) deposit all money received by them in designated depositories initially in demand deposits; and subsequently, if authorized by the court, in interest-bearing savings deposits, time certificates of deposit, or time deposits-open account; (3) account for and pay over to the estates under their control all interest received by them upon funds belonging to such estates; (4) disburse money only by check or draft on such depositories; (5) keep records and accounts showing all amounts and items of property received and from what sources, all amounts expended and for what purposes and all items of property disposed of; (6) set apart the bankrupts' exemptions allowed by law, if claimed, and report the liens and estimated value thereof to the courts as soon as practicable after their appointment; (7) examine the bankrupts (a) at the first meetings of creditors or at other meetings specially fixed for that purpose, unless they shall already have been fully examined by the referees, receivers, or creditors, and (b) upon the hearing of objections, if any, to their

discharges, unless otherwise ordered by the court; (8) examine all proofs of claim and object to the allowance of such claims as may be improper; (9) oppose at the expense of estates the discharges of bankrupts when they deem it advisable to do so; (10) furnish such information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; (11) pay dividends within ten days after they are declared by the referee; (12) report to the courts in writing the condition of the estates, the amounts of money on hand, and such other details as may be required by the courts, within the first month after their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority.

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estates subsequent to filing the petition; the fees for the referees' salary and expense

fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under Chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred

in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and

owing by the bankrupt to the United States or any State or any subdivision thereof; **Provided,** That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: **And provided further,** That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: **Provided,** however, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

11 U.S.C. §778 (Sec. 378 Bankruptcy Act). Procedure upon order directing that bankruptcy be proceeded with.

Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 721 of this title, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and (2) in the case of a petition filed under section 722 of this title, the proceeding shall be con-

ducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 72 of this title.

Internal Revenue Code of 1954:

26 U.S.C. Sec. 3504. Acts to be performed by agents. (As amended by Sec. 71, Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606)

In case a fiduciary, agent, or other person has the control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees, employed by one or more employers, the Secretary or his delegate, under regulations prescribed by him, is authorized to designate such fiduciary, agent, or other person to perform such acts as are required of employers under this title and as the Secretary or his delegate may specify. Except as may be otherwise prescribed by the Secretary or his delegate, all provisions of law (including penalties) applicable in respect of a nemployer shall be applicable to a fiduciary, agent, or other person so designated but, except as so provided, the employer for

whom such fiduciary, agent, or other person acts shall remain subject to the provisions of law (including penalties) applicable in respect of employers.

26 U.S.C. Sec. 4231. (6)—Cabarets.

A tax equivalent to 20 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. No tax shall be applicable under paragraph (1) or (2) on account of an amount paid with respect to which tax is imposed under this paragraph.

26 U.S.C. Sec. 6011. (a)—General requirement of return, statement, or list.

(a) General rule—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

26 U.S.C. Sec. 6012 (b)(3)—Receivers, trustees and assignees for corporations.

In a case where a receiver, trustee in bankruptcy, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

26 U.S.C. Sec. 6601(a). Interest on underpayment, nonpayment, or extensions of time for payment, of tax.

(a) General Rule. If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

26 U.S.C. Sec. 6651. Failure to file tax return.

(a) Addition to the tax. In case of failure to file any return or required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or a sub-

chapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

28 U.S.C. Sec. 960. Tax liability.

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Treasury Regulations on Employment Tax (1954 Code):

§31.6071(a)—1 Time for filing returns and other documents. (a) Federal Insurance Contributions Act and income tax withheld from wages. (1) Quarterly or Annual returns. Each return required to be made under §31.6011 (a)—1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be

made under §31.6011 (a)—4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve bank.

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 650

JOHN NICHOLAS, TRUSTEE OF THE ESTATE OF BEACHCOMBER MOTEL, INC., BANKRUPT,
PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (R. 21–25) is reported at 346 F. 2d 32. The order of the district court (R. 16) is not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on May 25, 1965 (R. 25–26). The trustee's petition for rehearing was filed on June 23, 1965 (R. 26–29) and was denied on July 9, 1965 (R. 29). The petition for a writ of certiorari was filed on October 6, 1965, and was granted on January 17, 1966 (R. 30; 382 U.S. 971). The jurisdiction of this Court rests on Section

24c of the Bankruptcy Act, as amended, and 28 U.S.C. 1254(1).

QUESTION PRESENTED

A debtor in possession operating its business during an arrangement proceeding under Chapter XI of the Bankruptcy Act incurred liability for withholding, employment and excise taxes. Thereafter, the debtor was adjudicated a bankrupt. The trustee in bankruptcy, while admitting his liability for the taxes, failed to pay them or to file tax returns when they became due. The question presented is whether the trustee is liable for delinquency penalties for failure to file timely returns and for interest on the unpaid taxes to the date of payment.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Bankruptcy Act, the Internal Revenue Code of 1954, the Judicial Code and the relevant Treasury Regulations are set forth in the Appendix, *infra*, pp. 28–37.

STATEMENT

On August 6, 1958, the Beachcomber Motel, Inc., finding itself unable to pay its debts as they matured, filed a petition for an arrangement under Chapter XI of the Bankruptcy Act in the United States District Court for the Southern District of Florida (R. 1–6). It proposed a partial payment of its current liabilities to unsecured creditors over a period of seven months (R. 1). During the pendency of the arrangement proceedings, the corporation remained in possession of its property and operated its business. During that

period, the debtor in possession hired and paid employees and withheld from their wages a total of some $467 for income and social security taxes as required by Sections 3102 and 3402 of the Internal Revenue Code of 1954.[1] The debtor also continued the operation of its cabaret and collected $644 in federal excise taxes from its patrons as required by Section 4231(6) of the Code.[2]

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[1] Section 3102 provides in part:

(a) *Requirement.*—The tax imposed by section 3101 [*i.e.* social security] shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. * * *

(b) *Indemnification of Employer.*—Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

Section 3402 provides in part:

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages * * * a tax equal to 14 percent of the amount by which the wages exceed the number of withholding exemptions claimed * * *.

Section 3403 provides:

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of such payment.

[2] Section 4231 provides in part:

There is hereby imposed:

* * * * *

(6) *Cabarets.*—A tax equivalent to 10 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit * * *.

The debtor was unable to work out a plan of arrangement with its creditors and was adjudicated a bankrupt on September 17, 1958 (R. 8). A trustee in bankruptcy, the petitioner here, was appointed on September 19, 1958.

On October 31, 1958, the taxes collected or withheld during the quarter ending September 30, 1958, as well as the employer's contribution to the social security tax imposed by Section 3111,[3] were due to be paid. The trustee did not pay them, nor did he file the returns with respect to those taxes which were required on the same date.[4] On January 31, 1959, the 1958

The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. * * *

[3] Section 3111 provides in part:

(a) *Rate of Tax.*—In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

[4] Section 6011(a) provides:

(a) *General Rule.*—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

See Treasury Regulations on Employment Tax (1954 Code), Sec. 31.6011(a)-1 and Sec. 31.6011(a)-4; Treasury Regulations 43 (1941 ed.), Sec. 101.33, and Treasury Regulations on Returns and Payment of Certain Excise Taxes, Sec. 477.2 (26 C.F.R. (1949 ed.) § 477.2).

payroll tax imposed on employers by the Federal Unemployment Tax Act fell due.[5] Again the trustee neither paid the tax nor filed the required return.

On April 11, 1963, the United States filed in the bankruptcy proceeding a proof of claim and an administrative expense statement (R. 9). The proof of claim covered approximately $700 for taxes which had accrued prior to the petition for an arrangement filed on August 6, 1958. That claim is not here in dispute. The administrative expense statement sought payment of (a) the taxes that had been withheld or collected or had accrued during the period of operations following the petition for an arrangement,[6] (b) the penalties that had been assessed pursuant to

[5] Sections 3301–3309. Section 3301 (26 U.S.C., 1958 ed.) provides:

> There is hereby imposed on every employer (as defined in section 3306(a)) for the calendar year 1955 and for each calendar year thereafter an excise tax, with respect to having individuals in his employ, equal to 3 percent of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)) after December 31, 1938.

See Treasury Regulations on Employment Tax (1954 Code), Sec. 31.6011(a)–4.

[6] No allocation between the pre-petition and post-petition periods was made with respect to the federal unemployment tax for 1958, and the entire 1958 tax ($362.29) was in the administrative expense statement (R. 9). While the attribution of the entire tax to the post-petition period may be questioned (see *Pomper* v. *United States*, 196 F. 2d 211 (C.A. 2)), petitioner has never objected to it. For each of the other taxes covered by the administrative expense statement, an allocation was made between the pre-petition and post-petition periods, and only the amounts accruing during the latter period were claimed.

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Section 6651(a) of the Code[7] for failure to file the various returns, and (c) the interest, under Section 6601(a)[8] on the overdue taxes and penalties that had accrued and would accrue until payment.[9]

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[7] Section 6651(a) provides in part:

(a) *Addition to the Tax.*—In case of failure to file any return * * * on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

[8] Section 6601(a) provides:

(a) *General Rule.*—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

[9] The amounts claimed as administrative expense taxes were itemized as follows (R. 9):

Withholding and Social Security, Qtr. ending 9/58	$519.89*
Assessed Penalty	129.97*
Assessed Interest to 2/2/62	101.54
Accrued Interest to 4/10/63	46.34
Excise, Qtr. ending 9/58	644.00*
Assessed Penalty	161.00*
Assessed Interest to 4/14/59	17.58
Accrued Interest to 4/10/63	192.35
FUTA, 1958	362.29*
Assessed Penalty	54.34*
Assessed Interest to 4/14/59	4.46
Accrued Interest to 4/10/63	99.55
Total Post-petition taxes	$2,333.31

*Plus interest on this amount at 6% per annum or at the rate of $0.31 per day from 4/11/63 to date of payment.

The trustee filed objections (R. 10–11) seeking to reduce the government's administrative expense claims by the amount of the penalties and interest; no objection was made to the claim for the principal amount of the taxes as an expense of administration. Both the referee and the district court allowed the principal of the taxes and the interest which had been assessed thereon (see fn. 9, *supra*) "as an Administrative Tax Claim in the amount of $1,649.76 entitled to a first priority" (R. 13, 16); they both disallowed the claim for penalties and for interest accruing since assessment.

The Court of Appeals for the Fifth Circuit reversed the disallowance of penalties and accrued interest (R. 25–26). The court stated that it was well settled that, although taxes accruing prior to bankruptcy are tax claims that have fourth priority in payment, taxes that accrue as a result of operations after bankruptcy "constitute an expense of administration under §62a of the Act and, as such, are payable as a First priority under § 64a" (R. 23). The court concluded (R. 24–25) that, since under the Bankruptcy Act, "the obligation of the trustee here was the same as if he had been in possession from the filing of the original [Chapter] XI proceedings" for taxes accruing after the petition for arrangement, the trustee was subject under *Boteler* v. *Ingels*, 308 U.S. 57, "to the same obligation to make required returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face."

ARGUMENT

INTRODUCTION AND SUMMARY

The liability of the trustee for the principal amount of the taxes set forth in the government's administrative expense statement (R. 9) is not in issue here. The referee found that the trustee was liable (R. 13), and the trustee has expressly conceded that "taxes incurred by a debtor in possession are entitled to priority under the first priority of Section 64 of the Bankruptcy Act as expenses of administration" (R. 28). The only question, therefore, is whether, where taxes constitute expenses of administration in bankruptcy because they result from the operation of a business by a debtor in possession during an arrangement proceeding, interest imposed by statute for delayed payment, and penalties imposed by statute for failure to file returns, may be collected together with the underlying taxes in the ensuing bankruptcy proceeding. That question is answered affirmatively by Section 960 of the Judicial Code which provides:

> Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business *to the same extent* as if it were conducted by an individual or corporation. [Emphasis added.]

This section makes both trustees in bankruptcy and debtors in possession liable for federal taxes and draws no distinction between operating and liquidat-

ing proceedings.[10] Moreover, interest and penalties on such taxes are included, since they are an integral part of the taxing system of the Internal Revenue Code, which provides that they shall be "assessed, collected, and paid in the same manner as taxes" and shall be deemed included in all references to taxes in the Code (Sections 6601(f)(1) and 6671(a)). The tax which Section 960 directs court officers and agents to pay "to the same extent" as ordinary businesses embraces the entire tax imposed by the revenue act, and, therefore, includes increments and additions to tax which the Court has recognized to be "the traditional and almost universal method of enforcing prompt payment." *Boteler* v. *Ingels,* 308 U.S. 57, 61.

Petitioner urges that such a reading of Section 960 conflicts with the overriding policy of the Bankruptcy Act against post-bankruptcy interest. In fact, however, there is no conflict. The principle that interest ceases to accrue after a petition for arrangement or for adjudication is properly applicable only to claims arising before the petition is filed is inapplicable to the subsequent costs of administering a debtor's estate under judicial supervision for the benefit of creditors. When a business is being conducted, either by a trustee or a debtor in possession, for purposes of liquidation or in the hope of revival, it is of great importance

[10] See *Boteler* v. *Ingels,* 308 U.S. 57 ("operations for purposes of liquidation"); *United States* v. *Sampsell,* 266 F.2d 631 (C.A 9); *City of New York* v. *Rassner,* 127 F. 2d 703, 706 n. 2 (C.A. 2); *In re Loehr,* 98 F. Supp. 402 (E.D. Wis.).

that others be willing to do business with it. Subject to court approval, a trustee will commonly have authority to hire, retain and pay employees and to buy goods for cash or credit. For like reason, Section 344 of the Bankruptcy Act provides for the borrowing of money, with court approval, "upon such terms and conditions and with such security and priority in payment over existing obligations as in the particular case may be equitable." In such transactions, no policy of the Bankruptcy Act proscribes the payment of interest or precludes payments on such contractual liabilities as they mature. Were it otherwise, it would be difficult or impossible for a trustee or a debtor in possession to condnct any business at all.

Federal (and other) taxes incurred after the commencement of proceedings under the Bankruptcy Act, like the commercial transactions that give rise to them, are expenses of administration. While the various taxing authorities, unlike commercial suppliers of goods, services and credit, can neither select their debtors nor negotiate terms and conditions, Section 960 directs that they shall be paid.

Petitioner's contention that the imposition of interest for delayed payment of taxes forces the "premature payment" of the government's claim (Br. p. 7) and is inequitable to other creditors (Br. p. 12) is without merit. It is inaccurate to suggest, as petitioner does, that all expenses of administration must be aggregated before any are paid lest the fund available be insufficient to meet all first priority claims. In the present case wages were paid before the taxes withheld from those wages became due. Moreover,

the bulk of the taxes here involved were withheld from wages, or collected from customers, by command of the Internal Revenue Code and for the benefit of the government. No unfairness to other creditors can be involved in the prompt surrender of such funds when due or in the imposition of interest when payment is deferred. Indeed, Section 7501 of the Code provides that taxes "collected or withheld shall be held to be a special fund in trust for the United States." Against such a trust fund, other actual or potential first priority claimants hold no claim. When such a fund arises in the hands of an officer of a court it is deemed to have been preserved for the beneficiary in accordance with equitable principles, and when it is not surrendered when due the beneficiary should be entitled to interest as the price for the delay in paying him.

Finally, none of the considerations which the petitioner has asserted has relevance to the contested penalties. The penalties were imposed because of the failure of the trustee to file the required returns. The returns could have been filed and the penalties avoided even if the trustee were unwilling or unable to make timely payment of the taxes. Since the trustee has never contested his eventual liability for the taxes, there can be no doubt of his duty to file the required returns. Clearly, the government may penalize the default in that duty.

I. WHEN A DEBTOR IN POSSESSION INCURS LIABILITY FOR FEDERAL TAXES IN THE OPERATION OF ITS BUSINESS DURING A PROCEEDING UNDER CHAPTER XI OF THE BANKRUPTCY ACT, INTEREST ON SUCH TAXES TO THE DATE OF PAYMENT CONSTITUTES AN ADMINISTRATION EXPENSE OF AN ENSUING BANKRUPTCY PROCEEDING.

A. TAXES ACCRUING AS A RESULT OF OPERATIONS DURING AN UNSUCCESSFUL CHAPTER XI PROCEEDING ARE COSTS OF ADMINISTRATION OF AN ENSUING BANKRUPTCY PROCEEDING

The petitioner has expressly conceded (R. 28) that "taxes incurred by a debtor in possession are entitled to priority under the first priority of Section 64 of the Bankruptcy Act as expenses of administration" and are not to be treated as pre-bankruptcy taxes (R. 28).[11] Implicit in that concession is the general proposition that

> * * * an indebtedness validly incurred by a receiver, trustee or debtor in possession during the administration of the proceeding under Chapter XI is a cost and expense of administration, and it continues to be such if bankruptcy is directed, and it is entitled to priority of payment as such. * * * [9 Collier, *Bankruptcy* (14th ed., 1964) ¶10.10 at 510.]

In other words, as the Second, Sixth and Ninth Circuits have held, "When the debtor was displaced by the bankruptcy trustee, there was no break in the continuity in relationship, for the order of adjudication

[11] In *Kalishman* v. *United States*, pending on petition for certiorari, No. 711, this Term, involving the identical issue as to interest, the trustee in bankruptcy did not deny that the taxes incurred by the debtor in possession were properly treated as administration expenses of the subsequent bankruptcy. See 346 F. 2d 514, 517 (C.A. 8). Pursuant to this Court's invitation (382 U.S. 968), petitioner Kalishman has filed a brief *amicus curiae* in this case.

related back and the original petition for an arrangement became the vital date." *City of New York* v. *Rassner*, 127 F. 2d 703, 706 (C.A. 2); *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938, 941 (C.A. 6); *United States* v. *Sampsell*, 193 F. 2d 154, 156 (C.A. 9); *In re Airline Arista Printing Corp.*, 156 F. Supp. 403, 405 (S.D.N.Y.), affirmed *per curiam*, 267 F. 2d 333 (C.A. 2).

Specific provisions of the Bankruptcy Act support this settled view that, when a Chapter XI proceeding is followed by bankruptcy, the obligations validly incurred by the debtor in possession during the Chapter XI proceedings are treated as if they had been incurred by the trustee during bankruptcy. Section 302, 11 U.S.C. 702, provides that "the date of adjudication shall be taken to be the date of the filing of the petition [for arrangement] under section 321 or 322 * * *." Section 378(2) provides that a bankruptcy proceeding which follows a Chapter XI proceeding "shall be conducted, so far as posisble, in the same manner and *with like effect* as if a voluntary petition for adjudication in bankruptcy had been entered on the day when the petition under this chapter [XI] was filed * * *" (emphasis added).[12]

[12] This view is further supported by Section 342, which gives a debtor in possession "all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court"; and by Section 343, under which "the receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor * * *." Both of these sections make clear the status of the debtor in possession as an officer of the court. See 8 Collier, *Bankruptcy* (14th ed., 1964) ¶ 6.31—¶ 6.32 at 957-967.

The gist of the matter is that expenses properly incurred by a debtor in possession as well as those incurred by a trustee in bankruptcy are given a special position by the Act and are collectively distinguished from those liabilities incurred before the estate was brought within the protection and control of the court.[13] The rule is required to effectuate Chapter XI's basic purpose of enabling distressed debtors to rehabilitate their affairs by adjusting their unsecured liabilities in cooperation with their creditors. Since a substantial proportion of Chapter XI proceedings terminate in bankruptcy,[14]

[13] The only distinction which the Bankruptcy Act makes between the administration expenses incurred in arrangement and bankruptcy proceedings clearly demonstrates that the first priority of payment in a bankruptcy proceeding includes the administration expenses of a prior, unsuccessful arrangement proceeding. Thus, the proviso to Section 64a(1) states:

> Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding * * *.

[14] See the following table:

Fiscal year ended June 30	Chapter XI proceedings filed	Chapter XI proceedings in which debtor adjudicated bankrupt
1961	947	370
1962	903	412
1963	1,188	485
1964	1,088	604

(Tables of Bankruptcy Statistics, published by the Administration Office of the United States Courts, for the fiscal years ending June 30, 1961, through 1964, Tables F2 and F4b, and for the fiscal year ending June 30, 1964, pp. 4 and 5.)

persons who deal with a debtor in possession during the arrangement proceedings would frequently be unwilling to extend him any credit at all—and thus preclude successful rehabilitation—if they knew that, should the arrangement fail, they would be in no better position than persons who extended credit before the arrangement. The Bankruptcy Act thus gives those who deal with an insolvent whose affairs are under judicial control a significantly superior position to those who dealt with him before that occurred.

Thus, in the present case, the trustee's liability for interest that accrued after bankruptcy on the taxes that had been incurred during the Chapter XI proceeding is the same as if the taxes had been incurred during the bankruptcy proceeding itself.

B. THE STATUTORY PLAN OF THE BANKRUPTCY ACT SHOWS THAT INTEREST ON FEDERAL TAXES INCURRED DURING BANKRUPTCY, LIKE THE TAXES THEMSELVES, CONSTITUTE ADMINISTRATION EXPENSES.

In its Proof of Claim and Administrative Expense Statement (R. 9) the government clearly distinguished between taxes accruing prior to the petition for an arrangement and those accruing thereafter. Pre-petition taxes, like all other provable claims, must be proved under Section 57 of the Act. Such taxes are entitled to only a fourth priority under Section 64a. Post-petition taxes, on the other hand, cannot be proved under Section 57, but come within the "actual and necessary costs and expenses" of administration which are subject to approval under Section 62 and, if approved, have first priority under Section 64a.

Michigan v. *Michigan Trust Co.*, 286 U.S. 334; Wurzel, *Taxation During Bankruptcy Liquidation*, 55 Harv. L. Rev. 1141, 1174 (1942); 3 Collier, *Bankruptcy* (14th ed., 1964) ¶ 62.14 at 1529, ¶ 64.106 at 2094.

A creditor whose claim arose prior to the petition for arrangement or adjudication may not prove post-petition interest on his claim. In *Sexton* v. *Dreyfus*, 219 U.S. 339, this Court, relying on the English common law, held that a secured creditor who sold his security after his debtor had filed a petition in bankruptcy could not apply the proceeds first to interest on the debt accruing after bankruptcy and then prove for the deficiency, but rather was required to apply the proceeds first to the liquidation of the debt and interest accrued to the date of the petition. Mr. Justice Holmes, writing for the Court, pointed out that the security could have been sold on the date of the petition—in which case the entire deficiency would have been provable—and that the delay in selling, prompted by the hope of getting a better price, was principally for the benefit of the secured creditor. *Id.* at 345. In *New York* v. *Saper*, 336 U.S. 328, the general rule of *Sexton* was applied to tax claims. In particular, the Court held that, in light of the 1926 and 1938 amendments to the Bankruptcy Act [15] which eliminated the absolute priority that taxes had previously enjoyed and also imposed the requirement that taxes be proved like other claims under Section 57, taxes had been "assimilated * * * to other debts" and, like them, should bear interest only

[15] Act of May 27, 1926, c. 406, 44 Stat. 662, Section 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Section 1.

to the date of bankruptcy and not to the date of payment (*id.* at 337).

While petitioner recognizes (Br. p. 12; see also brief for *amicus curiae* p. 10) that *Saper* dealt only with tax claims arising prior to bankruptcy,[16] he urges that it should be read as governing post-petition tax claims as well. Nothing in the Court's opinion supports that contention. First, *Saper* relied on *Sexton* which was clearly limited to pre-petition claims. Second, *Saper* was concerned with the implications of the subordination of tax claims to costs of administration effected by the 1926 and 1938 amendments; but post-petition taxes payable as costs of administration are not affected by that subordination. Third, *Saper* drew support from the Chandler Act's requirement in Section 57n that tax claims be proved, like all other provable claims, under Section 57; but costs of administration, including post-petition taxes, are not provable under Section 57. Finally, *Saper* did not even refer to the Court's earlier decision in *Boteler* v. *Ingels*, 308 U.S. 57, which held that a trustee in bankruptcy was liable for penalties for failure to pay a State tax which accrued while the business of the bankrupt was being operated for the purpose of liquidation. In sum, *Saper* is clearly limited to pre-petition taxes.

[16] *Saper* has been held applicable to arrangements under Chapter XI, *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80 (C.A. 8), affirmed *per curiam*, 342 U.S. 912. Therefore tax claims accruing prior to a petition for arrangement may bear interest up to but not after the date of the petition.

The decisions following *Saper* cited by petitioner (Br. pp. 12–14) have uniformly concerned pre-petition tax claims. On the other hand, in *In re International Power Securities Corp.*, 109 F. Supp. 544 (D. N.J.), a trustee in a Chapter X reorganization was held liable for the interest accruing on unpaid State franchise taxes where the underlying taxes were payable as administrative expenses. The court held that the claim for interest on such post-petition taxes was governed by the principle of *Boteler* and that the principle of *Saper* was inapplicable.

While *Saper* says nothing concerning interest on taxes accruing as a consequence of the post-petition operation of a business, insofar as *Saper* assimilates tax claims to other claims it implies that there is no bar to interest on post-petition taxes precisely because the Bankruptcy Act does not proscribe such interest on other post-petition claims. Where it is in the interest of pre-petition creditors that the operations of an insolvent business be continued in the hope of effecting rehabilitation or an orderly liquidation, the debtor in possession [17] or the trustee must be able to

[17] The operations carried on by a debtor in possession, like those of a trustee, are clearly intended to be for the benefit of the creditors:

> Thus, it has been held that a debtor in possession holds his powers in a trust for the benefit of the creditors, and that the creditors have the right to require the debtor in possession to exercise those powers for their benefit. It follows that a debtor in possession, in addition to his duty to exercise his power for the benefit of creditors, is under a duty to preserve and protect his title and to maintain his possession for the benefit of creditors. [8 Collier, *Bankruptcy* (14th ed., 1964) ¶ 6.32 at 961.]

transact business on terms which will induce others to deal with an insolvent. Subject to the supervision of the court, the trustee ordinarily may hire employees and pay them in accordance with the employment agreement (*In re Wil-low Cafeterias, Inc.*, 111 F. 2d 429 (C.A. 2)), buy and sell merchandise for cash or credit and pay for purchases in accordance with the terms of sale (*In re Avorn Dress Co.*, 78 F. 2d 681 (C.A. 2), and borrow money and repay it (*In re Delaware Hosiery Mills*, 202 F. 2d 951 (C.A. 3) (*dictum*)). Of course, money is not usually loaned or credit extended without charge—especially to insolvents. In order to facilitate such financial transactions where they serve the interests of the pre-petition creditors, Section 344 provides:

> During the pendency of a proceeding for an arrangement, or after the confirmation of the arrangement where the court has retained jurisdiction, the court may upon cause shown authorize the receiver or trustee, or the debtor in possession, to issue certificates of indebtedness for cash, property, or other consideration approved by the court, upon such terms and conditions and with such security and priority in payment over existing obligations as in the particular case may be equitable.

The purpose and hope of rehabilitation which prompt the commencement of arrangement proceedings and the temporary suspension of the claims of pre-petition creditors may well necessitate the incurring of new

obligations, including the costs of new credit."[18] Thus, the principle which bars post-petition interest on pre-petition claims simply has no bearing on post-petition claims.

In the present case, the debtor in possession incurred liability for taxes as a cost of administration. Those taxes were an inevitable incident to the continued employment of persons to run the business and the operation of a cabaret. The taxes were payable in accordance with the Internal Revenue Code, just as the wages from which the taxes were largely withheld were payable in accordance with the employment contract and just as the costs of the beverages consumed by the patrons of the cabaret were payable in accordance with the terms of the bill of sale. Under the terms of the Internal Revenue Code, the taxes were due on October 31, 1958, and January 31, 1959, and drew interest at 6 percent thereafter. By the very act of continuing to operate the business, the debtor in possession necessarily assumed the obligation to pay the taxes that the Code imposed.

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[18] "The necessity of borrowing money by a debtor in possession is so acute at times, that he is faced with the prospect of either borrowing money to use for his operations or closing his business. Often the loan cannot be procured from friendly sources, and the lender to protect his loan, desires a greater assurance of payment than a priority as an expense of administration on a parity with other expenses of administration. He may require a chattel mortgage on all the machinery, fixtures and equipment of the debtor in possession, or a first lien on all the assets.

"* * * [An order under Section 344] generally sets forth the terms and conditions of *interest*, repayment and the assets to be pledged, if any. * * *" [Weintraub and Levin, *Practical Guide to Bankruptcy and Debtor Relief* (1964) 185–186 (emphasis added).]

If the pre-petition creditors believed that continued operations, with the attendant costs, were more likely to deplete than augment the debtor's assets, they were free to seek an adjudication of bankruptcy. The operations having been continued and taxes having been incurred in consequence, the debtor in possession and his successor trustee, as officers of the court, were liable for such taxes "to the same extent" as if the business had been "conducted by an individual or corporation" (28 U.S.C. 960). Since no principle of bankruptcy law precludes interest on post-petition obligations, there is no reason not to accord the Internal Revenue Code its usual effect.

C. SINCE THE SUMS WITHHELD AND COLLECTED AS TAXES BY THE DEBTOR IN POSSESSION CONSTITUTE A TRUST FUND FOR THE GOVERNMENT, THE TRUSTEE CANNOT JUSTIFY HIS FAILURE TO PAY OVER SUCH SUMS TO THE GOVERNMENT BY THE ALLEGED NEED TO HOLD THEM FOR RATABLE PAYMENT AMONG ALL FIRST PRIORITY CLAIMANTS.

Petitioner urges (Br., p. 15) that if post-petition interest is allowed the trustee is "faced with a dilemma" because premature payment of the taxes "may be at the peril of reducing his estate and not having sufficient assets to pay administration expenses superior to the tax claim." Were the government claiming interest on a pre-petition claim, the trustee's contention would have great force. Since, however, the government's tax claim arises from the post-petition operation of the business, it is hard to see why the timely payment of taxes presents any greater dilemma than the timely payment of the wages from which the taxes were in large part withheld.

While petitioner's contention seems irrelevant to post-petition claims in general, it is particularly inappropriate in the present case where the bulk of the taxes had either been withheld from the wages of employees or collected from the patrons of the cabaret.[19] As to the amounts which had been withheld or collected, the debtor in possession was essentially a collecting agent and custodian for the government. Accordingly, the sums involved did not constitute a fund to which other creditors were entitled to look for the satisfaction of their claims. Indeed, it was a fund which was collected solely by virtue of the Internal Revenue Code and was held solely for the government. Since both the debtor in possession and the trustee were officers of the court and subject to the court's surveillance, there would have been no inequity or unusual burden in requiring that such a fund be surrendered to the government when due.[20]

The special status of the fund collected by the debtor in possession is not left to inference or surmise. Section 7501 of the Internal Revenue Code provides:

> (a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United

[19] The aggregate principal amount of taxes due is $1,526.18. Of that amount, approximately $1,111.00 had been withheld or collected.

[20] The trustee's interim report of July 5, 1961 (R. 18) shows that he had a balance on hand of $8,842.13 after paying out $3,824.76 for a variety of administrative expenses.

> States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

It has been held repeatedly that Section 7501 is applicable to taxes withheld or collected by a debtor in possession or a trustee and that the fund must be surrendered by the trustee. *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938 (C.A. 6); *United States* v. *Sampsell*, 193 F. 2d 154 (C.A. 9); *City of New York* v. *Rassner*, 127 F. 2d 703 (C.A. 2); *In re Airline-Arista Printing Corp.*, 156 F. Supp. 403 (S.D.N.Y.), affirmed *per curiam*, 267 F. 2d 333 (C.A. 2). The government is entitled to the fund of which it is the beneficiary even though the trustee is unable to pay in full all of the other costs of administration. *City of New York* v. *Rassner, supra; In re Airline-Arista Printing Corp., supra.*

Similarly, the status of the fund is not affected by the provision in Section 64a(1) of the Bankruptcy Act granting precedence (within the first priority) to costs and expenses of an ensuing bankruptcy proceeding over the costs and expenses of a superseded arrangement proceeding. *In re Airline-Arista Printing Corp., supra.* Moreover, because the taxes withheld or collected by a debtor in possession have been continuously under the control of an officer of the court and subject to the supervision of the court, the government need not trace the fund in order to claim the trust. *Hercules Service Parts Corp.* v. *United States, supra;*

United States v. *Sampsell, supra.* As the Second Circuit wrote in *Rassner* (127 F. 2d at 706):

> * * * If we hold that the city must now trace the funds, we state in effect that any beneficiary of a trust which is handled by an officer of a bankruptcy court must always protect himself by petitioning in advance for proper administration of the trust. Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it.

Petitioner does not suggest that he did not have sufficient funds available to pay the taxes. The trustee's interim report (R. 17–18) indicates that more than enough cash was available. Since the government had an exclusive right to the sums which had been collected for it, no reason appears why it should not have been timely paid or, failing that, why it should not receive interest to compensate for the delay in payment.

II. THE TRUSTEE IS LIABLE FOR THE STATUTORY PENALTIES FOR FAILURE TO FILE RETURNS

The arguments advanced above with respect to the trustee's liability for interest demonstrate as well that his claim to immunity from the penalties assessed is unfounded. Indeed, the present case is ruled by *Boteler* v. *Ingels,* 308 U.S. 57, where the Court held a trustee in bankruptcy liable for a 100-percent penalty for failure to pay a California automobile license tax which accrued while he was operating the bankrupt's business for purposes of liquidation. The Court there ruled that, since the tax liability and the

penalties were incurred by the trustee after bankruptcy, the State "could not file proof of claim for these fees and penalties as a creditor under § 57" (308 U.S. at 60) and therefore Section 57j, which "prohibits allowance of tax penalties accruing prior to bankruptcy" (*id.* at 59), was inapplicable.[21] The Court found (*id.* at 61) that, under the predecessor of 28 U.S.C. 960 (48 Stat. 993 (1934)), Congress had "with vigor and clarity declared that a trustee and other court appointees who operate businesses must do so subject to state taxes 'the same as if such business[es] were conducted by an individual or corporation'". The Court stated (*ibid.*):

> * * * If businesses in California not conducted by a bankruptcy trustee are delinquent in the fees, they must pay the penalty. However, petitioner's contention would exempt a trustee operating a business in bankruptcy from this double tax liability which other delinquents must bear. A State would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment.

The reasoning in *Boteler* is equally applicable to the present case, and similarly compels the conclusion that the trustee in bankruptcy here is liable for the statutory penalties that the Internal Revenue Code

[21] In *Simonson* v. *Granquist*, 369 U.S. 38, the Court held that Section 57(j) bars allowance of a claim for tax penalties even though a lien therefor has been perfected prior to filing the petition in bankruptcy. Because, as *Boteler* holds, Section 57(j) is inapplicable to penalties incurred after bankruptcy, *Simonson* does not govern the present case.

imposes for failure timely to file returns. The decision in *Boteler* does not turn upon the fact that it was the State which imposed the penalty but upon the broader ground that, with respect to liabilities incurred while operating a business, a court officer stands on no different footing than anyone else conducting such business.

As we have shown above, the fact that the taxes here accrued while the business was being operated by the debtor in possession in no way relieves the succeeding trustee of the liability. Nor does the trustee deny his liability for the tax. Since "any person made liable for any tax [imposed by the Code] * * * shall make a return" (Section 6011(a)), there is no basis for petitioner's contention (R. 22) that he was under no duty to file returns.

Even if there were merit in the trustee's contention that there is some undue burden in requiring the prompt payment of taxes or some inequity in charging interest for delayed payment, no reason is suggested why the returns could not have been filed on time. Yet it is solely for the failure to file timely returns that penalties are imposed under Section 6651 of the Internal Revenue Code. Thus, even on the supposition that there were valid reasons to defer payment of the taxes, the penalty could have been averted by merely filing the returns without payment of the taxes.

Furthermore, such penalties are imposed "unless it is shown that such failure is due to reasonable cause and not due to willful neglect * * *" (Section 6651 (a)). Since the trustee has never suggested that his default was due to reasonable cause it must be assumed

that it was due to willful neglect. No policy of the bankruptcy law is served by immunizing such conduct from statutory penalties.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APRIL 1966.

APPENDIX

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 57. *Proof and Allowance of Claims.* * * *

* * * * *

(j) [as amended by Sec. 14(a), Act of July 7, 1952, c. 579, 66 Stat. 424]. Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

* * * * *

(11 U.S.C., Sec. 93.)

SEC. 62 [as amended by Sec. 11(a), Act of June 28, 1946, c. 512, 60 Stat. 329]. *Expenses of Administering Estates; Unauthorized Sharing of Fees; Withholding Allowances.*—a. (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * *

(11 U.S.C., Sec. 102.)

SEC. 64 [as amended by Sec. 19(a), Act of July 7, 1952, c. 579, 66 Stat. 426]. *Debts Which Have Priority.*—a. The debts to have

priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * the costs and expenses of administration, * * * *Provided, however,* That where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any;" * * *.

(11 U.S.C., Sec. 104.)

SEC. 321. A debtor may file a petition under this chapter in a pending bankruptcy proceeding either before or after his adjudication.

(11 U.S.C., Sec. 721.)

SEC. 322. If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication.

(11 U.S.C., Sec. 722.)

SEC. 342. Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe.

(11 U.S.C., Sec. 742.)

SEC. 343. The receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.

(11 U.S.C., Sec. 743.)

SEC. 378. Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 321 of this Act, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and

(2) in the case of a petition filed under section 322 of this Act, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 44 of this Act.

(11 U.S.C., Sec. 778.)

28 U.S.C.:

§ 960. *Tax liability.*

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Internal Revenue Code of 1954:

SEC. 3102. DEDUCTION OF TAX FROM WAGES.

(a) *Requirement.*—The tax imposed by section 3101 [i.e. social security] shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. * * *

(b) *Indemnification of Employer.*—Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

* * * * *

SEC. 3111. RATE OF TAX.

In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

* * * * *

SEC. 3301. RATE OF TAX.

There is hereby imposed on every employer (as defined in section 3306(a)) for the calendar year 1955 and for each calendar year thereafter an excise tax, with respect to having individuals in his employ, equal to 3 percent of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)) after December 31, 1938.

* * * * *

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages * * * a tax equal to 14 percent of the amount by which the wages

exceed the number of withholding exemptions claimed * * *.

* * * * * *

SEC. 3403. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of such payment.

SEC. 4231. IMPOSITION OF TAX.

* * * * * *

(6) *Cabarets.*—A tax equivalent to 20 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. No tax shall be applicable under paragraph (1) or (2) on account of an amount paid with respect to which tax is imposed under this paragraph.

SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

(a) *General Rule.*—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

* * * * * *

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) *General Rule.*—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

* * * * * *

SEC. 6651. FAILURE TO FILE TAX RETURN.

(a) *Addition to the tax.*—In case of failure to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

* * * * * *

SEC. 6659. APPLICABLE RULES.

(a) *Additions Treated as Tax.*—Except as otherwise provided in this title—

(1) The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

(2) Any reference in this title to "tax" imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

* * * * *

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(b) *Penalties.*—

For penalties applicable to violations of this section, see sections 6672 and 7202.

Treasury Regulations on Employment Tax (1954 Code):

§ 31.6071(a)–1 *Time for filing returns and other documents.*

(a) *Federal Insurance Contributions Act and income tax withheld from wages.*—(1) *Quarterly or annual returns.* Each return required to be made under § 31.6011(a)–1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be made under § 31.6011(a)–4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes

due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve bank.

* * * * *

(26 C.F.R., Sec. 31.6071(a)–1.)

§ 31.6151–1. *Time for paying tax.*

(a) *In general.* The tax required to be reported on each tax return required under this subpart is due and payable to the district director at the time prescribed in § 31.6071(a)–1 for filing such return. See the applicable sections of 26 CFR Part 301 (Regulations on Procedure and Administration), for provisions relating to interest on underpayments, additions to tax, and penalties.

(b) *Use of Government depositaries.* For provisions relating to the use of Federal Reserve banks and authorized commercial banks in depositing the taxes, see §§ 31.6302(c)–1 and 31.6302(c)–2.

(26 C.F.R., Sec. 31.6151–1.)

Treasury Regulations on Procedure and Administration (1954 Code):

§ 301.6601–1. *Interest on underpayments.*

* * * * *

(f) *Applicable rules.* (1) Any interest prescribed by section 6601 shall be assessed and collected in the same manner as tax and shall be paid upon notice and demand by the district director or the director of the regional service center. Any reference in the Code (except in subchapter B, chapter 63, relating to deficiency

procedures) to any tax imposed by the Code shall be deemed also to refer to the interest imposed by section 6601 on such tax. Interest on a tax may be assessed and collected at any time within the period of limitation on collection after assessment of the tax to which it relates. For rules relating to the period of limitation on collection after assessment, see section 6502.

* * * * *

(26 C.F.R., Sec. 301.6601–1.)

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965

No. 650

JOHN NICHOLAS, TRUSTEE OF THE ESTATE OF BEACHCOMBER MOTEL, INC., BANKRUPT,
Petitioner

v.

UNITED STATES OF AMERICA

On Writ of Certiorari to The United States Court of Appeals for the Fifth Circuit

---

REPLY BRIEF OF PETITIONER

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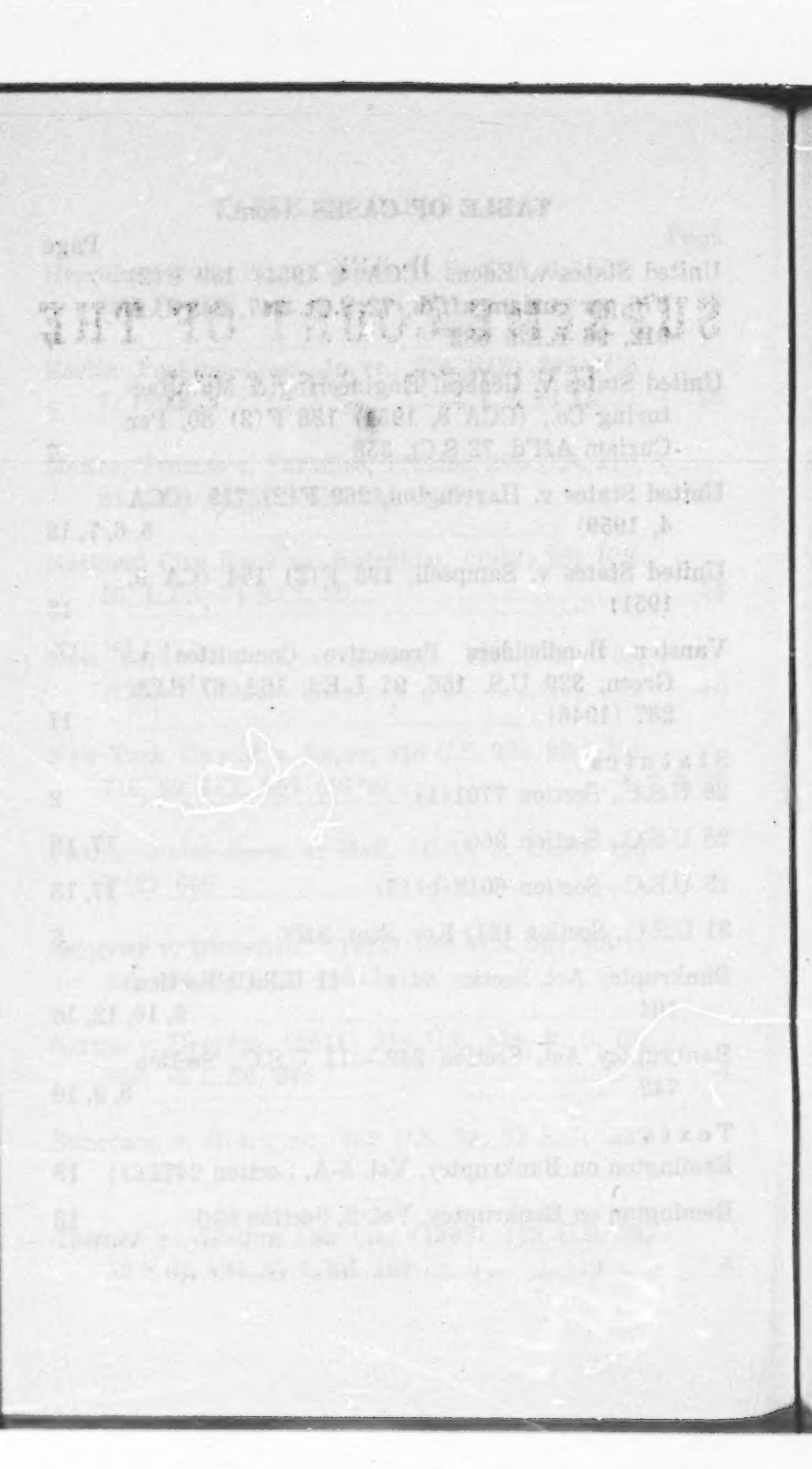

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REPLY BRIEF OF PETITIONER

INTRODUCTION

The sections in the Government's Brief entitled "Opinions Below" and "Jurisdiction" are correct.

STATUTES AND REGULATIONS

Statutes Involved:

In addition to the Statutes and Regulations cited to the Court in the Petitioner's Main Brief, and the Brief of the United States, 26 U.S.C., §7701 (1) of the Internal Revenue Code is pertinent:

> "Definitions
>
> (1) Person. — The term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation."

QUESTIONS PRESENTED

1. Whether the United States is entitled to recover from the assets of a bankruptcy estate, as part of a cost-of-administration claim, interest to date of payment on a claim for unpaid taxes incurred by a debtor-in-possession, while operating a business during the pendency of an arrangement proceeding under Chapter XI prior to adjudication.

2. Whether a trustee in bankruptcy is liable for penalties for failure to file tax returns for taxes when the taxes were the liabilities of a predecessor debtor-in-possession.

STATEMENT OF THE CASE

The statement of the facts in the brief of the United States is substantially correct, but requires some correc-

tion and clarification. When Beachcomber Motel, Inc. was adjudicated a bankrupt on September 17, 1958, the trustee appointed to liquidate the estate received no money, accounts receivable, or any tangible property, either real or personal, from the debtor in possession that had preceded him. (R. 17 and 18)

Therefore, the statements in the Government's brief to the effect that the trustee failed to pay taxes due on September 30, 1958, have little significance; the trustee had no resources from which to pay such taxes, even if it were proper for him to deviate from the priority prescriptions of the Bankruptcy Act.

The further contention by the Government that the trustee in bankruptcy should have filed a return on and paid on January 31, 1959, the F.U.T.A. taxes incurred by the debtor in possession, for the last quarter of 1958, infers to the Court that the trustee was responsible for the debtor's return and tax payment. It should be noted that none of the taxes at issue were incurred or collected by the trustee in bankruptcy; all accrued during the debtor in possession period, between August 6, 1958 and September 17, 1958. There is no specific statutory requirement that the trustee file the returns and pay the tax when due, as suggested by the Government in its statement of the facts.

The objections filed by the trustee to the Government's administrative expense claim objected to all penalties and post petition interest subsequent to the filing date of the original petition, on August 6, 1958.

The trustee was upheld by the Referee in Bank-

ruptcy (R. 12 and 13) and by the United States District Court on review by the United States (R. 14 and 15).

ARGUMENT

PART 1

THE GENERAL RULE IS THAT POST PETITION INTEREST ON TAX CLAIMS IN BANKRUPTCY IS NOT ALLOWABLE.

Petitioner's main brief demonstrated that the rule against allowance of post petition interest on tax claims is a long recognized, equitable rule, having its roots in over a century and a half of English bankruptcy practice which, as noted by Justice Holmes in **Sexton v. Dreyfus** (1911 219 U. S. 389, 31 S. Ct. 256, 55 L. Ed. 244, this nation accepted into its framework of law.

The development of the rule has been based on logical considerations and equitable principles that were memorialized in **City of New York v. Saper,** (1949) 336 U. S. 328, 69 S. Ct. 554, 93 L. Ed. 710, where the opinion by Mr. Justice Jackson recognized that the denial of post petition interest is in complete accord with the intent of Congress to assimilate "taxes to other debts for all purposes, including denial of post petition interest."

Since 1893, in **Thomas v. Western Car Company,** 149 U. S. 95, 13 S. Ct. 824, 37 L. Ed. 163, this court has recognized that after the property of an insolvent passes into the hands of a court officer, interest is not allowable on claims against the funds, and that delay in distribution of these funds occurs by act of law, as an incident to

settlement of the estate, and is not the fault of the court officer against whose estate the infliction of interest would fall. Since this time it has been well recognized in bankruptcy as well as other insolvency proceedings, that interest upon claims stops with initiation of proceedings.

In bankruptcy cases, the courts have been unanimous in holding that, generally, interest upon claims does not accrue after the filing of the petition, whether the claims are secured or unsecured. See **United States v. Harrington**, 269 F(2) 719, (CA 4, 1959) and cases there cited.

There have been two well established exceptions to this rule;

1. Where the bankrupt ultimately proves to be solvent

2. Where securities, held by the creditor, produce income after the filing of the petition. **United States v. Harrington, supra.**

Through the years, both secured creditors and the Government have sought to upset the statutory prescription of priorities, which form an integral and fixed part of the federal bankruptcy pattern, by seeking to carve out new judicial exceptions to the "no post petition interest" rule. The Courts, however, consistently have refused to recognize such new exceptions and have adhered to the express requirements of the Bankruptcy distribution statutes, as expressive of Congressional intent, as facilitative of practical administration of bankruptcy estates, and for equitable considerations, since to

grant such interest must be at the expense of other creditors entitled, by Statute, to dividend participation, possibly equal to that of the United States if the interest were denied.

Thus, in **United States v. Harrington**, supra, the Court of Appeals for the Fourth Circuit rejected another attempt to create a new exception, in favor of a Government claim for interest on its tax obligation, a claim was grounded on the argument that post bankruptcy interest is allowable to a secured creditor where the amount of the security is sufficient to satisfy both principal and interest on the secured claim and the Government if it holds a tax lien, is a secured creditor secured by all the property of the bankrupt and, since the sum total of all the bankrupt's assets could pay the principal of the Government claim plus interest, the other creditors of the estate would suffer, the Government was entitled to interest upon its tax claim until the date of payment, regardless of the punishing effect of such payment on other creditors, of equal or less priority.

In **Guaranty Title and Trust Company v. Title Guarantee & Surety Company**, 224 U. S. 152, 56 L. ed. 706, 32 S. Ct. 457 (1912) this Court refused to grant a super priority to the taxing authorities based on the then effective Revised Statute, Section 3466, 31 U.S.C. 191, which gave the United States priority on payment of tax cases in insolvency proceedings, holding that the Bankruptcy Act and its specification of priorities, controlled, in Bankruptcy proceedings.

In **Pacific States Corp. v. Hall** (CCA 9, 1948) 166

F(2) 668, the secured creditor insisted that another exception should be made to the no post petition interest rule in bankruptcy where the value of the security was in excess of the principal and interest. The court denied this interest.

Similarly, as is noted in **U.S. v. Harrington**, supra, though this court in **City of New York v. Saper**, supra, "intended to put the question to rest once and for all," the Government still continued to urge the courts to "confine the **Saper** case ruling to the specific situation existing in that case." (**U.S. v. Harrington**, at 721, citing **In Re Cameron**, (DC Sc. Cal. 1958), 156 F.Supp. 400

Thus, the Government sought, unsuccessfully, in **U.S. v. Edens**, (CCA 4, 1951) 189 F(2) 876, aff. 342 U.S. 912, 96 L.Ed. 682, 72 S. Ct. 357 to insulate Chapter X Reorganization proceedings from the ordinary bankruptcy rule of the **Saper** case, and in **U.S. v. Gen. Engineering & Mfg. Co.** (CA 8 1951) 188 F(2) 80, to avoid the application of the rule of the Saper case, in Chapter XI arrangement cases. Again, at **342 U.S. 912, 96 L.Ed.** 682, 72 S. Ct. 357 this Court, on the express authority of the **Saper** case, affirmed.

Various decisions have rebuffed the Government's effort to extend the doctrine to situations where Government's tax claims have been reduced to liens. These cases are collected in **U.S. v. Harrington**, supra.

The Government now seeks to create a new exception to the established "no post petition interest" rule of the **Saper, Edens** and **General Engineering** cases, contending that post petition interest should be granted

where the claim was incurred by a debtor in possession in an abortive debtor relief proceedings, where though there were no physical assets transferred to a succeeding trustee upon adjudication, this Trustee subsequently generated proceeds through liquidation of certain claims, sufficient (R 18) to pay a partial dividend on tax claims, Federal and local (R 5, 6).

The Government's position, as it sets out in its main brief, rests on, and requires acceptance of, three completely fictional concepts:

1. The concept that the debtor in possession and the succeeding trustee, elected upon adjudication, after displacement of the debtor in possession, have a common responsibility devolving from their common identity as "court officers". This fiction, considering antagonists as being responsible for each other's conduct, ignores the fact, well known to this court, that the debtor in possession and the trustee represent completely opposite vehicles, arrangement versus bankruptcy administration, of continued operation in arrangement proceedings versus liquidation upon rejection, by the creditors, of the proposed arrangement or other failure of the Debtor's Plan or operation. It is impossible to see why responsibility should be fixed upon the creditors' representative for the misconduct of the subject of the creditors' complaint in the arrangement proceedings, the operating debtor. There can be, between the debtor in possession and a trustee, only the most formal privity, and neither the trustee, himself, nor the creditors whom he represents, should respond, directly or indirectly, for the defalcations of a debtor in possession. While Section 342 of the Bankruptcy Act (11 U.S.C. 742, Resp. App. 29) vests the Debtor

in Possession with the powers of a trustee, no place in the Act is the Trustee charged with responsibility for the Debtor's misdeeds.

Our main brief has pointed out that it would be most inappropriate for a court of equity to indulge in a fiction to reach an unconscionable result, casting an inequitable burden upon other creditors, who must be deprived of a portion of their dividends in favor of one whose statutory priority has been prescribed by the Bankruptcy Act, as no higher than that of some of the sacrificing creditors.

2. The second fiction urged by the Government, at pages 15, 16 and 17 of its brief, and in its attempted distinction of the **Saper** case, from the facts at hand, is that the relevant decisions deal with tax claims of two priorities, accruing during two periods of time, i.e. pre-petition and post-petition, both with reference to the filing date of the proceedings; and that in numerous cases the courts award interest on post-petition taxes.

The fallacy of this assumption is that it ignores the existence of the 1952 amendment to §64(a) (1) of the Bankruptcy Act. (Government's Appendix 28) which, as set out in Petitioner's Main Brief, defines **three** periods of time with respect to the accrual of claims, the pre-petition period, the arrangement period, subsequent to the Petition but prior to adjudication, and the post-adjudication period. Each period has a specific assigned, different priority by Section 64(a) (1) of the Bankruptcy Act, supra.

In this connection, at page 10 of its Brief, the Gov-

ernment raises the spectre of the hypothetical lender, making a loan to a debtor in possession, necessary for continuation of its operations. The Government equates its position to this lender and assumes both would be paid all interest, in full. The Government fails to pursue this analogy fully, for such a creditor, lending to a debtor in possession, under a general order of authority, would discover in the event of subsequent adjudication, that his loan would be repayable only to the extent that it would participate, pro rata, with other arrangement administrative expenses, subordinate to and after full payment of liquidation expenses which are accorded a super priority by the 1952 amendment to §64(a) (1) of the Bankruptcy Act.

3. The third fiction urged by the Government to raise its exception urged to the "no post petition interest" rule is the doctrine of the fictitious trust fund. (Page 21, Argument C of the Government's Brief.) which shall be discussed in part two of this brief.

Recently, in Bruning v. U. S. 376 U. S. 358, 11 L.Ed. (2) 772, 84 S. Ct. 906 (1964) this Court acknowledged the essential soundness behind **New York v. Saper**. Mr. Chief Justice Warren stated at 376 U.S. 363 11 Ed. 2 775, 84 S.Ct. 908

> "The basic reasons for the rule denying post-petition interest as a claim against the bankruptcy estate are the avoidance of unfairness as between competing creditors and the avoidance of administrative inconvenience."

citing **American Iron & Steel Mfg. Co. v. Seaboard Air-**

line RR Co. 233 U. S. 261, 58 L.Ed 949, 34 S.Ct. 502 and, also, Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 91 L.Ed. 162, 67 S. Ct. 237 (1946).

Petitioner submits that the compelling argument for suspension of interest, in a bankruptcy, on pre-petition debts is equally forceful when applied to any pre-adjudication debts that accrued in a debtor relief proceeding. The nature of that proceeding suggests this result because income and activity have ceased and it is inequitable and impractical to prefer one class of creditors by arguing that the adjudication in bankruptcy is legally insignificant.

Boteler v. Ingels, 308 U. S. 57, 84 L. Ed. 78, 60 S. Ct. 29 (1939), imposed penalties on an operating trustee in bankruptcy for failure to pay State taxes that directly connected with his operation. Such an imposition on an operating trustee is logical, but certainly the reasons for the imposition is not analogous to the priority claims in a liquidating bankruptcy that follows an unsuccessful debtor relief proceeding.

The public policy of forcing the timely and early payment of taxes through the imposition of interest on the procrastinating taxpayer, whether he be an individual or an operating trustee, cannot be logically applied in the case of the liquidating trustee administering an estate such as Beachcomber Motel, Inc., Bankrupt.

The reasoning of this court in Simonson v. Granquist, 369 U. S. 38, 7 L. Ed. (2) 557, 82 S. Ct. 537 (1962) in the consideration of tax penalties in bankruptcy where the taxes had been perfected to a lien involved the same

logic with respect to interest. The court said: "tax penalties are incurred at least in part as punitive measures against persons who have been guilty of some defaults or wrongs. Enforcement of penalties against the estate of bankrupts, however, would serve not to punish the delinquent taxpayer, but rather their entirely innocent creditors."

It is not the trustee in bankruptcy who will suffer if he is required to pay claims prematurely or pay interest on payments which were deferred because the trustee did not have funds available for payment at the time the Internal Revenue Statutes would ordinarily require payment if a bankruptcy had not occurred. The creditors will bear the burden of the Government's interest imposition and if the liquidating administration does not have sufficient assets to pay all expense of administration claims in full, the Government will have gained an advantage on creditors of equal dignity under Section 64(a) of the Bankruptcy Act.

PART 2

TO CONTEND THAT SUMS OF MONEY WITHHELD AND COLLECTED AS TAXES, BY A DEBTOR IN POSSESSION, EVEN THOUGH EXPENDED AND UNTRACEABLE, CONSTITUTE A "TRUST FUND" TO CREATE A NOVEL, EXTRA-STATUTORY PRIORITY, IS UNREALISTIC, INEQUITABLE, AND UNWARRANTED.

The Government has recited to the Court various Court of Appeal cases in which the principal portion of

taxes collected in debtor relief proceedings were impressed with a trust in the hands of a superseding bankruptcy trustee. In no instance do the cases cited by the Government[1] support the exaction of interest on claims administered by the Bankruptcy Trustee; and, to the contrary it would appear that the reasoning of **In Re Kerber Packing Co.**, 276 F(2) 245 (CA 7, 1960); **U. S. v. Harrington, supra**, and **Simonson v. Granquist, supra**, is more appropriate, where interest and penalties were denied on taxes reduced to liens.

Parenthetically, reference to the Respondent's Proof of Claim (R-9) shows that the Government did not claim a trust fund, or the status of a secured creditor by reason thereof, in its Proof of Claim, did not assert any doctrine of trust, nor in any way assert a position as a beneficiary of the trust before the Referee in Bankruptcy. It is a position raised, de novo, on review or appeal, and, as such, we submit, is improper. **Fortson v. Dorsey**, 379 U. S. 433, 13 L. ed(2) 401, 85 S. Ct. 498 (1965).

We suggest that if a trust fund in fact existed, the Government should have been relegated to the summary process of the Bankruptcy turnover order (5-A **Remington on Bankruptcy**, Sec 2471, et seq.) and, further, that the filing of the claim by the Government without reference to any security claimed therefor constitutes a legal waiver of any security it may have had for its claim 2 **Remington on Bankruptcy** §980.

As has been noted above, there were no physical

[1]New York v. Rassner (CCA-2 1942) 127 F2 703; Hercules Service Parts Corp. v. U. S. (CA-6, 1963) 302 F2 938; U. S. v. Sampsell (CA-9 1959) 266 F2 631; Airline-Arista Printing Corp., (DCNY 1957) 156 F. Supp. 868.

assets transferred by the debtor-in-possession, Beachcomber Motel, Inc., to the liquidating trustee and apparently the same circumstances existed in the case of Seymour Wallis (Brief, amicus curiae, pg. 7).

We submit that the idea of creating a trust without a res on which it can be imposed is alien to both the law of trusts and the law of Bankruptcy. It is a fiction, without either a need or justification therefor.

Petitioner urges that this Court consider the well established rule that in order for a trust to exist there must be a fund or res in existence. **City of Dallas v. Crippen,** 171 F(2) 526 (CCA 5, 1949) stated the rule as follows:

> "If the bankrupt holds property in trust for another, the trustee in bankruptcy takes title to such property charged with the trust. So long as the property can be identified according to sound trust doctrine of tracing identification, it will be treated in bankruptcy as property to which creditors of the bankrupt have no claim, and will be paid over as a whole before disbursements are made to lien holders or unsecured creditors."

Considerable authorities supporting the rule that there must be a fund or a trust property in order for a trust to exist, find a basis in **National City Bank v. Hotchkiss,** 34 S. Ct. 20, 231 U.S. 50 in which Justice Holmes stated:

> "a trust cannot be established in alloquit share of a man's whole property, as distinguished from

> a particular fund, by showing that the trust moneys had gone into it. On similar principals a lien cannot be asserted upon a fund in a borrowers hands, which, at an earlier stage, might have been subject to it, if, by consent of the claimant, it had been a part of the borrowers general estate. But that was the result of the dealings between these parties, and it cannot be done away with by a wish or intention,..."

The **Hotchkiss** decision was followed by **Adams v. Champion**, (1935) 294 U.S. 231, 79 LEd 880, 55 S Ct. 399, in which Justice Cardozo restated the rule as follows:

> "They may be implements of justice in cases of theft or actual fraud. They may not be applied as to impose a trust by relation upon money that has entered into the 'stream of the firm's general property' and are distinguishable no longer."

The need for a res as a predicate for a trust in a bankruptcy situation was considered in **McKee, Trustee, v. Paradise, as Trustee**, 299 U. S. 119, 81 L. Ed. 75, 57 S. Ct. 129, (1936). Here, deductions made for the benefit of employees welfare association which were not deposited in a special account or "segregated" but were handled through bookkeeping entries, were contended by the association to constitute trust funds in the hands of the bankruptcy trustee. This Court, rejecting this argument stated:

> "The bankrupt was a debtor which had failed to pay its debt. We know of no principle upon

> which that failure can be treated as a conversion of property held in trust. At no time throughout the whole period was there a trust fund or res." (299 U.S., at 123)

Following the same principle is Schuyler, v. Littlefield, 232 U.S. 707, 58 L. Ed. 806, 34 S. Ct. 466 (1914). The court acknowledged that if identification of alleged trust funds is not clearly established by the evidence, that doubt must be resolved in favor of the Trustee in Bankruptcy.

The position of the Government that a trust should be imposed notwithstanding the absence of a res, is not only contrary to established doctrine but such a rule does considerable violence to the priority specifications of the Bankruptcy Act. Certainly the very existence of the costs of administration priority and its superior position under Sec. 64(a) of the Bankruptcy Act should carry with it, the implication that this is the only special privilege that should be granted to "costs of administration". No additional advantage should be accorded on either a trust or other fictional doctrine.

Adoption of a trust fiction necessarily invites a race by Governmental authorities to see which one can be the first to impress a trust outside and contrary to the provisions of Section 64(a) of the Bankruptcy Act. The Court should evaluate the claim of the Government within the framework of the Bankruptcy Act and decline to permit the imposition of a trust.

PART 3.

A TRUSTEE IN BANKRUPTCY SHOULD NOT INCUR STATUTORY PENALTIES FOR FAILURE TO FILE TAX RETURNS WHEN THE RETURNS WERE NOT HIS RESPONSIBILITY.

It is petitioner's contention that there is no obligation for a trustee in bankruptcy to file returns for the collections of withholding, F.I.C.A., F.U.T.A. and excise taxes when the taxes were not incurred during his administration.

The requirements of applicable statutes place the responsibility for filing returns as to such taxes on those persons who, in fact, made the collections.

There are no clearly defined statutory instructions placing this responsibility upon a trustee in bankruptcy and, therefore, to say that his failure to file a return is willful, is as prejudicial as it is meaningless.

There is only one statute requiring the filing of tax returns by a trustee in liquidating bankruptcy, and this statute does not apply to the taxes in question in the instant case, but relates only to income tax returns for corporations whose trustee has "possession or holds title to all or substantially all of the property of the business or corporation whether or not such property or business is being operated." 28 U.S.C., 6012(b)(3).

The Government suggests that 28 U.S.C., Section 960, which applies only to trustees "conducting a business"

would also apply to a liquidating trustee elected following an unsuccessful debtor relief proceeding. There is no basis for this suggestion.

We submit that Congress recognized a distinction between the trustee who conducts a business and the trustee that does not, in the above described section relating only to income taxes, 28 U.S.C., Section 6012 (b)(3), therefore, it follows that 28 U.S.C., Section 960 expressly relating only to a trustee conducting a business is inapplicable to the liquidating trustee, conducting no business and incurring no current tax liability.

There is, therefore, no express statutory duty on the non-operating trustee to carry out his predecessor debtor's statutorily prescribed reporting duties.

Both the Government and the decision of the Court of Appeals for the Fifth Circuit expressly rest upon **Boteler v. Ingels**, 308 U. S. 57, 84 L. Ed. 78, 60 S. Ct. 29 (1939), where this court upheld penalties against an operating trustee arising from his failure to pay license taxes incurred in favor of the State of California by the operation **by the Trustee** of motor vehicles on the highways of the State.

The reasoning of the Boteler case is inapplicable to the facts of the matter at hand. The trustee in Boteler was an operating trustee, rather than the non-operating liquidating trustee of Beachcomber Motel, Inc. whose major activities were the collection of the proceeds of litigation. The distinction between operating and liquidating trustees is well recognized; it was reiterated by the Court of Appeals for the Ninth Circuit on two occasions,

California Board of Equalization v. Goggin, 191 F(2) 726, (CCA 9, 1951)., 245 F(2) 44 (CA 9 1957)

Internal Revenue Statutes which require the return of collections for Withholding, FICA, FUTA and Excise taxes, place the responsibility for reporting on the persons collecting the revenue. The collector here was the debtor-in-possession or more specifically the managing officers of the Beachcomber Motel, Inc. and it was the responsibility of these officers to return to the government any collections of revenue and that responsibility continued notwithstanding the ensuing bankruptcy. Summarily, the Statutes do not require and it is inequitable to judicially prescribe, that the trustee assume the responsibility of making returns for revenue which he did not collect or even receive from the Debtor in Possession.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed and the District Court and the Referee in Bankruptcy affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, JOHN H. GUNN, Attorney for JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Petitioner, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 15 day of April, 1966, I served copies of the foregoing REPLY BRIEF OF PETITIONER by mail, by depositing the same in a United States mail box, with first class postage prepaid, addressed to counsel of record at their post office addresses, as follows:

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SUPREME COURT OF THE UNITED STATES

No. 650.—October Term, 1965.

John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Petitioner,
v.
United States.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

[June 13, 1966.]

Mr. Justice Stewart delivered the opinion of the Court.

The question presented in this case is whether a superseding trustee in bankruptcy is liable for interest and penalties on federal taxes incurred by a debtor in possession during an arrangement proceeding under Chapter XI of the Bankruptcy Act. The facts are not in dispute.

On August 6, 1958, Beachcomber Motel, Inc., a Florida corporation operating a motel in Miami Beach, filed an original petition for an arrangement with its unsecured creditors under Chapter XI. Bankruptcy Act § 322, 11 U. S. C. § 722 (1964 ed.). During the pendency of the arrangement proceeding, the corporation was permitted to operate its business as a debtor in possession under the authority of the bankruptcy court. In the course of its business operations, the corporation withheld federal income taxes [1] and social security taxes [2] from the wages paid to its employees and collected federal excise taxes on the receipts from its

[1] Internal Revenue Code of 1954, § 3402, 26 U. S. C. § 3402 (1964 ed.).

[2] Internal Revenue Code of 1954, § 3102, 26 U. S. C. § 3102 (1964 ed.). See also Internal Revenue Code of 1954, § 3111, 26 U. S. C. § 3111 (1964 ed.).

cabaret.[3] Subsequently, the corporation was dispossessed of its property and the motel premises were closed.

Unable to proceed with a plan of arrangement with its creditors, the corporation filed a petition in bankruptcy on September 17, 1958, and was adjudged a bankrupt on the same date. Bankruptcy Act § 376 (2), 11 U. S. C. § 776 (2) (1964 ed.). On September 19, 1958, a trustee in bankruptcy, the petitioner in this case, was appointed. On October 31, 1958, the federal income taxes withheld, as well as the social security taxes and the cabaret taxes, were due to be paid. On January 31, 1959, the payroll tax imposed on employers by the Federal Unemployment Tax Act was due.[4] The trustee in bankruptcy neither paid these taxes nor filed any of the returns required with respect to them. On April 11, 1963, the United States submitted an administrative expense statement in the bankruptcy proceeding, claiming as administrative expenses the principal of the taxes due, penalties assessed for the trustee's failure to file the returns for the taxes,[5]

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[3] Internal Revenue Code of 1954, § 4231 (6), 26 U. S. C. § 4231 (6) (1964 ed.).

[4] Internal Revenue Code of 1954, § 3301, 26 U. S. C. § 3301 (1964 ed.).

[5] See § 6651 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 6651 (a) (1964 ed.), which provides:

"*Addition to the tax.*

"In case of failure to file any return . . . on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate."

The maximum penalty of 25% was assessed on the withholding, cabaret, and social security taxes, and a 15% penalty was assessed on the payroll tax. No question is raised in this case concerning the statutory requirement of willfulness.

and interest that had accumulated and would continue to accumulate on the taxes and penalties until they were paid.[6]

The referee in bankruptcy allowed the Government's claim for the principal of the taxes but disallowed the claims for penalties and interest.[7] The referee's order was affirmed in all respects by the District Court. The Court of Appeals for the Fifth Circuit reversed the judgment of the District Court and allowed the claims for penalties and interest on the taxes. 346 F. 2d 32. Shortly after that decision, the Court of Appeals for the Eighth Circuit reached the opposite result with respect to a similar claim by the Government for interest on taxes incurred during a Chapter XI proceeding,[8] and we granted certiorari to resolve this conflict. 382 U. S. 971.

I.

It is a well-settled principle of American bankruptcy law that in cases of ordinary bankruptcy, the accumula-

[6] See § 6601 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 6601 (a) (1964 ed.), which provides:

"*General rule.*

"If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid."

[7] The referee did in fact allow part of the Government's claim for interest, representing the portion that had accrued to the dates the respective taxes were assessed against the bankrupt corporation. The trustee sought no review of this anomalous aspect of the referee's order, and the allowance of this portion of the interest is not an issue in this case. Nor did the trustee challenge the referee's allowance of the principal of the taxes as an expense of administration. See *Dayton* v. *Stanard*, 241 U. S. 588; *Michigan* v. *Michigan Trust Co.*, 286 U. S. 334; *In re Lambertville Rubber Co.*, 111 F. 2d 45 (C. A. 3d Cir.); *In re Columbia Ribbon Co.*, 117 F. 2d 999 (C. A. 3d Cir.); *McColgan* v. *Maier Brewing Co.*, 134 F. 2d 385 (C. A. 9th Cir.); 3 Collier on Bankruptcy 2088 (1964 ed.).

[8] *United States* v. *Kalishman*, 346 F. 2d 514.

tion of interest on claims against a bankrupt estate is suspended as of the date the petition in bankruptcy is filed. *Sexton* v. *Dreyfus*, 219 U. S. 339.[9] That rule, grounded in historical considerations of equity and administrative convenience, was specifically made applicable to the accumulation of interest on claims for taxes by the decision of this Court in *New York* v. *Saper*, 336 U. S. 328.[10]

[9] Cf. *Thomas* v. *Western Car Company*, 149 U. S. 95, 116–117. It is clear that the interest-bearing quality of the debt is suspended, rather than extinguished, by the filing of a petition in bankruptcy. In certain circumstances not here relevant, the accrual of interest may continue during the period of bankruptcy administration. Cf. *Bruning* v. *United States*, 376 U. S. 358; 3 Collier on Bankruptcy 1858 ff. (14th ed. 1964). See 2 Blackstone, Commentaries *488.

[10] The decision of the Court in *New York* v. *Saper*, 336 U. S. 328, reflected an assimilation of tax debts to the status of other debts in bankruptcy. At the time *Sexton* v. *Dreyfus*, 219 U. S. 319, was decided, taxes incurred before bankruptcy enjoyed a highly preferred status in the succeeding bankruptcy liquidation. Thus, § 64a of the Bankruptcy Act of 1898, 30 Stat. 563, granted an absolute priority to claims for taxes and imposed an affirmative duty on the trustee in bankruptcy to seek out and ascertain the amount of taxes owed and to obtain an order from the bankruptcy court for payment. See *New York* v. *Saper*, 336 U. S. 328, 333. As a concomitant of their absolute priority, tax claims were permitted to accumulate interest even after the date the petition in bankruptcy was filed. See *In re Kollak*, 147 F. 276 (D. C. D. N. D.); *United States* v. *Childs*, 266 U. S. 304. In 1938, however, Congress amended the Bankruptcy Act by reducing tax debts to the status of a fourth priority, 52 Stat. 874, 11 U. S. C. § 104 (a) (1964 ed.), and by requiring tax claims to be proved in the bankruptcy proceeding like ordinary debts, 52 Stat. 867, 11 U. S. C. § 93 (n) (1964 ed.). Cf. Act of May 27, 1926, c. 406, § 15, 44 Stat. 666; Wurzel, Taxation During Bankruptcy Liquidation, 55 Harv. L. Rev. 1141, 1145–1146. In *Saper*, the Court held that, in the light of these amendments, tax debts had become sufficiently clothed with the characteristics of other bankruptcy debts to justify the application of the general rule in *Sexton* to suspend the accrual of interest on such claims on the date the petition in bankruptcy was filed.

The debts in *Sexton*, like the taxes in *Saper*, were incurred during the regular business operations of the taxpayer, prior to the invocation of any procedures under the Bankruptcy Act, whereas the taxes in the present case were incurred after a petition invoking Chapter XI of the Act had been filed. On the basis of that distinction, the Government contends that the taxes here in question were entitled to bear interest throughout the bankruptcy period. We draw no such conclusion from that distinction.

We believe that the decisions of this Court in *Sexton* and *Saper* reflect the broad equitable principle that creditors should not be disadvantaged *vis-à-vis* one another by legal delays attributable solely to the time-consuming procedures inherent in the administration of the bankruptcy laws.[11] In the context of interest-bearing debts, the equitable principle enunciated in *Sexton* and *Saper* rests at bottom on an awareness of the inequity that would result if, through the continuing accumulation of interest in the course of subsequent bankruptcy proceedings, obligations bearing relatively high rates of interest were permitted to absorb the assets of a bankrupt estate whose funds were already inadequate to pay the principal of the debts owed by the estate.[12]

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[11] As Mr. Justice Holmes stated with regard to interest on a secured debt in *Sexton* v. *Dreyfus*, 219 U. S. 339, 344–345:

"The rule is not unreasonable when closely considered. It simply fixes the moment when the affairs of the bankrupt are supposed to be wound up. If, as in a well known illustration of Chief Justice Shaw's, *Parks* v. *Boston*, 15 Pick. 198, 208, the whole matter could be settled in a day by a pie-powder court, the secured creditor would be called upon to sell or have his security valued on the spot, would receive a dividend upon that footing, would suffer no injustice, and could not complain."

[12] See *American Iron & Steel Manufacturing Co.* v. *Seaboard Air Line Railway*, 233 U. S. 261, a case of equity receivership, where the Court stated that the general rule barring post-petition interest on

To be sure, the amount of interest that accumulates on a debt incurred during a Chapter XI arrrangement depends upon the duration of a proceeding that takes place under the direction and authority of the bankruptcy court. Bankruptcy Act §§ 342, 343, 11 U. S. C. §§ 742, 743. But interest claimed on such a debt does not arise through a "delay" of the law in any meaningful sense. The underlying obligation of the debtor in possession is incurred as part of a judicial process of rehabilitation of the debtor that the procedures of Chapter XI are designed to facilitate. Interest on a current Chapter XI obligation is therefore different in kind from interest claimed during the arrangement period on a debt incurred before the Chapter XI petition was filed. From

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pre-petition claims is not based on the fact that the claims "had lost their interest-bearing quality during that period, but is a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full. If all claims were of equal dignity, and all bore the same rate of interest, from the date of receivership to the date of final distribution, it would be immaterial whether the dividend was calculated on the basis of the principal alone or of principal and interest combined. But some of the debts might carry a high rate and some a low rate, and hence inequality would result in the payment of interest which accrued during the delay incident to collecting and distributing the funds. As this delay was the act of the law, no one should thereby gain an advantage or suffer a loss. For that and like reasons, in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt." 233 U. S., at 266. See also *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 164: "Moreover, different creditors whose claims bore diverse interest rates or were paid by the bankruptcy court on different dates would suffer neither gain nor loss caused by delay." This equitable doctrine was itself the product of compromise between the interests of competing creditors; it was at least arguable that the intervention of bankruptcy should have prohibited payment even of pre-petition interest on debts until the principal of the debts was paid. See 3 Collier on Bankruptcy (14th ed., 1964), pp. 1855–1856.

the vantage point of pre-arrangement creditors, the panorama of a Chapter XI proceeding is intimately bound up with the intrusion of the bankruptcy law into the previously untrammelled relationship between a debtor and his creditors. For these creditors, the filing of the Chapter XI petition may legitimately be regarded as introducing the very sort of legal delay that bankruptcy courts, in denying claims for interest, have traditionally characterized as inequitable. On the other hand, from the vantage point of the creditor whose credit relationship arose during the Chapter XI proceeding itself, it is the subsequent filing of a petition in bankruptcy that marks the intervention of meaningful legal delays. The equitable rationale underlying our decisions in *Sexton* and *Saper* is therefore fully applicable to cases in which a Chapter XI proceeding is superseded by a liquidating bankruptcy.[13]

The principle that our past decisions thus establish is that the accumulation of interest on a debt must be suspended once an enterprise enters a period of bankruptcy administration beyond that in which the underlying interest-bearing obligation was incurred. In *Saper*, there were two relevant periods to be considered—the pre-petition period, before the petition in bankruptcy was filed, and the post-petition period, during the bankruptcy liquidation. The Court there upheld the accumulation

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[13] Nothing in the general language of § 378 (2) of the Bankruptcy Act, 11 U. S. C. § 778 (2), which provides that a bankruptcy proceeding superseding a Chapter XI proceeding "shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter [XI] was filed," requires us to collapse these important distinctions between an arrangement proceeding and a superseding bankruptcy and to treat the taxes in question here as though they were incurred in the bankruptcy proceeding itself.

of interest throughout the pre-petition period on taxes incurred during that period; it rejected only the claim for post-petition interest on the pre-petition taxes. By contrast, the circumstances of the present case commend a division into three periods—the pre-arrangement period, the arrangement period, and the liquidating bankruptcy period. A tax incurred within any one of these three periods would, we think, be entitled to bear interest against the bankrupt estate until, but not beyond, the close of the period in which it was incurred. Thus, in a case concerning taxes incurred during the first period—that is, before the filing of a petition for a Chapter XI arrangement—the Court has summarily affirmed a judgment holding that the accumulation of interest must be suspended as of the date the Chapter XI petition was filed.[14] Where, as in the present case, the taxes have been incurred in the Chapter XI proceeding itself, application of the principle enunciated in *Sexton* and *Saper* permits interest to accrue throughout the arrangement proceeding; the principle requires only that the accumulation of interest be suspended once a petition in bankruptcy is filed.

The allowance of interest on Chapter XI debts until the filing of a petition in bankruptcy promotes the availability of capital to a debtor in possession and enhances

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[14] *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80 (C. A. 8th Cir.), aff'd 342 U. S. 912. Cf. *Massachusetts* v. *Thompson*, 190 F. 2d 10 (C. A. 1st Cir.), cert. denied 342 U. S. 918. The same rule has been applied to suspend interest both in corporate reorganization proceedings under Chapter X of the Bankruptcy Act, *United States* v. *Edens*, 189 F. 2d 876 (C. A. 4th Cir.), aff'd 342 U. S. 912, and in assignments for the benefit of creditors, *Matter of Pavone Textile Corp.*, 302 N. Y. 206, 97 N. E. 2d 755, aff'd *sub nom. United States* v. *Bloom*, 342 U. S. 912. In accord with these decisions, the United States filed no claim in the present case for interest accruing in the arrangement and liquidating bankruptcy periods on taxes incurred before the Chapter XI petition was filed.

the likelihood of achieving the goal of the proceeding, the ultimate rehabilitation of the debtor.[15] Disallowance of interest on Chapter XI debts might seriously hinder the availability of such funds and might in many cases foreclose the prospect of the debtor's recovery.[16] No such significant detriment to the viability of a Chapter XI proceeding is imposed by the suspension of interest once the proceeding enters the liquidating bankruptcy period, since potential creditors can readily adjust their interest rates to accommodate their prognosis of the particular debtor's chances of rehabilitation.

The division of the proceedings in the present case into three separate periods defining the permissible accumulation of interest is supported by the threefold hierarchy of priorities for tax claims under the Bankruptcy Act. Taxes incurred in the pre-arrangement period must be content with a fourth priority under § 64a (4) of the Bankruptcy Act.[17] On the other hand, taxes incurred

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[15] Cf. *Massachusetts* v. *Thompson*, 190 F. 2d 10, 11 (dissenting opinion of Judge Woodbury). Section 344 of the Bankruptcy Act, 11 U. S. C. § 744, specifically contemplates the creation of interest-bearing debts during the arrangement period. See also Weintraub & Levin, Practical Guide to Bankruptcy and Debtor Relief 185–186 (1964).

[16] On the basis of statistics in the Brief of the United States submitted in this case, it appears that significant numbers of Chapter XI proceedings terminate in bankruptcy. For example, in the fiscal year ending June 30, 1964, 1,088 Chapter XI proceedings were filed, and a debtor was adjudicated a bankrupt in 604 such proceedings that had been initiated in 1964 or prior years.

[17] Section 64a of the Bankruptcy Act, 11 U. S. C. § 104 (a), provides:

"*Debts which have priority.*

"(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition . . . . Where an order is entered in a proceeding under any chapter of

during the arrangement period are expenses of the Chapter XI proceedings and are therefore technically a part of the first priority under § 64a (1).[18] The final sentence of that section, however, subordinates arrangement expenses within that priority to the expenses of the superseding bankruptcy administration. Tax claims incurred during Chapter XI proceedings are therefore in fact junior to claims for expenses incurred in subsequent bankruptcy proceedings. The suspension of interest on taxes incurred during the arrangement period as of the date a bankruptcy petition is filed thus corresponds to the suspension of interest on pre-arrangement taxes when a Chapter XI petition is filed. Moreover, the suspension of interest extricates the superseding trustee from a serious dilemma he would otherwise face, whether to pay subordinated Chapter XI tax claims prematurely in order to forestall the accrual of interest, or to increase the burden on the bankrupt estate by allowing the interest to accumulate.[19]

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this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding . . . (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof . . . ."

[18] See note 17, *supra*. The final sentence of § 64a (1) was added by Congress in 1952, 66 Stat. 426, as amended, 76 Stat. 571.

[19] The general principle restricting post-bankruptcy interest to the relevant time period in which the underlying obligation was incurred is also consistent with § 63a (1) of the Bankruptcy Act, 11 U. S. C. § 103 (a)(1) (interest on judgments and written instruments allowed only to date of filing of petition in bankruptcy; rebate of interest required if debt was not then payable and did not bear interest), and § 63 (a)(5), 11 U. S. C. § 103 (a)(5) (interest allowed only to date of petition on debts reduced to judgment after bankruptcy). Compare *Missouri* v. *Barhart*, 111 F. 2d 992, 996–997 (C. A. 8th Cir.).

Aside from its basis in the equitable principle that creditors of a bankrupt estate should not be disadvantaged solely by means of the law's delay, the confinement of the accrual of interest on Chapter XI obligations to the arrangement proceeding itself is also grounded in significant considerations of administrative convenience. As the Court recognized in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 164, "Accrual of simple interest on unsecured claims in bankruptcy was prohibited in order that the administrative inconvenience of continuous recomputation of interest causing recomputation of claims could be avoided." Thus, by accepting as a cut-off the date of filing of the petition in bankruptcy, the trustee avoids the potentially laborious procedure of recalculating the pro rata share to which each Chapter XI creditor is entitled whenever a distribution in the supervening bankruptcy is carried out.[20]

The application of the principle of our past decisions to the facts of the present case is straightforward. Since the taxes in question were incurred during the Chapter XI arrangement proceeding itself, the United States was entitled to interest on those taxes for the duration of that period. The actual arrangement proceeding in this case, however, terminated before the taxes became payable, and, therefore, no interest on the taxes accumulated before the petition in bankruptcy was filed by the debtor in possession. The entire amount of interest sought by the United States represents interest claimed for the liquidating bankruptcy period. Since we hold that the accumulation of interest on debts incurred during Chapter XI proceedings is suspended on the date the petition in the superseding bankruptcy is filed, it is clear that

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[20] See *Ex parte Bennet*, 2 Atk. 526, 527; *New York* v. *Saper*, 336 U. S. 328, 334; *Bruning* v. *United States*, 376 U. S. 358, 362; 3 Collier on Bankruptcy 1857 (14th ed. 1964).

the United States is not entitled to the interest that it seeks on the taxes in this case.

The result here is in no way inconsistent with the provisions of 28 U. S. C. § 960, which states that persons conducting a business under the authority of a federal court shall be taxed as if they were conducting a private business.[21] As an officer of the bankruptcy court, the debtor in possession was fully subject to taxes and interest incurred during his operation of the business in the Chapter XI arrangement. Nothing in the general language of 28 U. S. C. § 960, however, necessarily subjects the trustee in the superseding bankruptcy proceeding to an obligation to pay additional interest on those prior taxes once a petition in bankruptcy has been filed. *United States* v. *Kalishman*, 346 F. 2d 514; cf. *New York* v. *Saper*, 336 U. S. 328; *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80 (C. A. 8th Cir.), aff'd 342 U. S. 912. In the absence of explicit congressional direction, the considerations of equity and administrative convenience established by our decisions under the Bankruptcy Act clearly support this interpretation of the scope of this provision of the Judicial Code.

We find no merit in the Government's alternative suggestion that the interest on two of the taxes here in question—those withheld from the wages of employees and those collected from the patrons of the cabaret—constitutes a trust fund over which the United States has an absolute priority under § 7501 (a) of the Internal Rev-

[21] "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation." 28 U. S. C. § 960 (1964 ed.).

enue Code.[22] We need not here determine whether, with regard to the *principal* of those taxes, the general language of § 7501 (a) overrides the strong policy of § 64 a (1) of the Bankruptcy Act, which establishes a sharply defined priority that places all expenses of administration on a parity, including claims for taxes.[23] Cf. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152; *Davis* v. *Pringle*, 268 U. S. 315; *Missouri* v. *Ross*, 299 U. S. 72. The second sentence of § 7501 (a) specifically provides that interest on such a trust fund is collectible in the same manner as the taxes from which the fund arose. Since we have already determined that no interest on any of the taxes here in question accrues beyond the period of the arrangement proceeding, no interest could accumulate on a trust fund composed of the withholding and cabaret taxes.[24]

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[22] Section 7501 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 7501 (a) (1964 ed.), provides:

"*General rule.*

"Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose."

Cf. *City of New York* v. *Rassner*, 127 F. 2d 703 (C. A. 2d Cir.); *United States* v. *Sampsell*, 193 F. 2d 154 (C. A. 9th Cir.); *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938 (C. A. 6th Cir.); *In re Airline-Arista Printing Corp.*, 267 F. 2d 333 (C. A. 2d Cir.); 3 Collier on Bankruptcy 2066, n. 27 (14th ed. 1964).

[23] The record indicates that the assets of the bankrupt estate are sufficient to pay all expenses entitled to priority under § 64a (1) of the Bankruptcy Act, and the United States has not sought to claim the *principal* of the taxes in question as a trust fund. See note 7, *supra*.

[24] We thus have no occasion to determine whether in any event interest, which would necessarily be derived from the assets of the bankrupt estate, could accede to the principal of such a trust fund.

We therefore reverse the judgment of the Court of Appeals with regard to the liability of the trustee for the interest on the taxes.

II.

The validity of the claim by the United States against the trustee for penalties for failure to file the returns for the taxes in question presents a completely different issue. The result here is governed squarely by the rationale of our decision in *Boteler* v. *Ingels*, 308 U. S. 57, in which we sustained a penalty against a trustee in bankruptcy who failed to pay state automobile license taxes incurred while he was operating the business of the bankrupt estate for the purpose of liquidation. We held in *Boteler* that Congress, under the predecessor of 28 U. S. C. § 960,[25] had "with vigor and clarity declared that a trustee and other court appointees who operate businesses must do so subject to state taxes 'the same as if such business[es] were conducted by an individual or corporation.'" 308 U. S., at 61. As we stated in *Boteler*, if the trustee were exempt from the penalty, a "State would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment." *Id.*, at 61.[26]

The same considerations are equally applicable to the present case. It is conceded that the trustee, in his status as representative of the bankrupt estate and successor in interest to the debtor in possession, is liable for the principal of the taxes incurred by the debtor in pos-

[25] See note 21, *supra*.

[26] Cf. *In re Chicago & N. W. Ry. Co.*, 119 F. 2d 971 (C. A. 7th Cir.). See also § 6659 (a)(1) of the Internal Revenue Code, 26 U. S. C. § 6659 (a)(1), which provides that penalties on taxes "shall be assessed, collected, and paid in the same manner as taxes."

session, to the extent of the priority enjoyed by the taxes under § 64a (1) of the Bankruptcy Act.[27] Once that liability is established, there can be no question that, under § 6011 (a) of the Internal Revenue Code, the trustee was under an obligation to file returns for these taxes, even though the taxes themselves were incurred by the debtor in possession during the pendency of the arrangement proceeding.[28] It therefore follows under *Boteler* that,

[27] The liability of the trustee for the principal of these taxes results from his succession in interest to the title of the debtor in possession, who, as an officer of the bankruptcy court, was clearly subject to such taxes under the provisions of 28 U. S. C. § 960, *supra*, note 21. As the successor in interest, the trustee is bound by all authorized acts of the debtor in possession. *In re Wil-low Cafeterias*, 111 F. 2d 429 (C. A. 2d Cir.); 8 Collier on Bankruptcy 965 (14th ed. 1964). Cf. Shapiro, Tax Effects of Bankruptcy, 1959 So. Calif. Tax Inst. 587, 588–591. In general, the trustee himself is under a duty to seek out and pay taxes accruing against the bankrupt estate during the bankruptcy itself. See 2 Collier on Bankruptcy 1752 (14th ed. 1964). Cf. Internal Revenue Code of 1954, § 6012 (b)(3) (trustee required to make returns of income for bankrupt corporation whether or not the business of the corporation is being operated). Unlike the situation in Part I, *supra*, the present question involves no major inequities between creditors of the same class. The dominant aspect here, therefore, is the continuity of interest between the debtor in possession and the trustee as officers of the bankruptcy court. The crucial fact in the present case, so far as the obligation to file the tax returns is concerned, is that the taxes were in fact incurred during proceedings under the Bankruptcy Act. Thus, nothing said in this opinion may be taken as imposing any obligation upon a trustee in bankruptcy to file returns for taxes incurred before the initiation of proceedings under the Act. Cf. I. T. 3959, 1949–1 C. B. 90 (trustee not authorized to file federal income tax returns on behalf of a bankrupt individual).

[28] Section 6011 (a) of the Internal Revenue Code of 1954, 26 U. S. C. § 6011 (a), provides:

"*General rule.*

"When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement accord-

in the circumstances of the present case, where a Chapter XI arrangement has been superseded by a liquidating bankruptcy under the Bankruptcy Act, the United States is entitled to exact the penalties here in question as a legitimate means to enforce the prompt filing of the tax returns. Although the rule in *Boteler* may be open to some question as applied to the facts of that case, no such difficulty is presented here. In *Boteler*, the trustee was penalized for his failure actually to *pay* the license fees within the time period prescribed by the State, even

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ing to the forms and regulations prescribed by the Secretary or his delegate. . . ."

Since it is clear that under § 6011 (a) the trustee himself was required to file returns for the taxes in issue, we need not determine whether penalties incurred by the debtor in possession may be assessed against the trustee. See §§ 57 (j) and 381 (3) of the Bankruptcy Act, 11 U. S. C. §§ 93 (j), 781 (3); *Boteler* v. *Ingels*, 308 U. S. 57, 59–60. Nor is there any issue raised in this case concerning the susceptibility to tax under 28 U. S. C. § 960 of a trustee whose activities do not amount to the conduct of business in any meaningful sense. See *United States* v. *Sampsell*, 266 F. 2d 631 (C. A. 9th Cir.); *In re Loehr*, 98 F. Supp. 402 (D. C. E. D. Wis.). *In the matter of F. P. Newport Corp., Ltd.*, 144 F. Supp. 507 (D. C. S. D. Cal.).

Nothing in § 6151 of the Internal Revenue Code, 26 U. S. C. § 6151 (1964 ed.), which obliges the person required to file a return to pay the tax in question, imposes any obligation on the trustee other than in his capacity as the representative of the bankrupt estate. Nor is § 3467 of the Revised Statutes, 31 U. S. C. § 192, applicable here. It is well-established that this provision, which imposes a personal liability on a trustee who distributes the property of a bankrupt estate to other creditors before satisfying the debts due the United States, does not alter the priorities established by § 64a of the Bankruptcy Act. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152; *United States* v. *Kaplan*, 74 F. 2d 664 (C. A. 2d Cir.). Cf. *King* v. *United States*, 379 U. S. 329. Compare *Boteler* v. *Ingels*, 308 U. S. 57, 60, n. 6; *In re Lambertville Rubber Co.*, 111 F. 2d 45, 49–50 (C. A. 3d Cir.).

though it could not have been clear at that date that the assets of the bankrupt estate would be sufficient to pay all of the expenses of administration that were entitled to share equally with the taxes under the first priority of § 64a (1) of the Bankrupty Act in any distribution of assets from the estate. In the present case, on the other hand, the penalties were imposed solely because of the trustee's failure to file timely returns for the taxes incurred during the Chapter XI arrangement period.[29] No legitimate interest would be served by permitting the trustee to escape the unburdensome responsibility of merely filing the returns and thereby notifying the United States of the taxes that are due. We therefore affirm the judgment of the Court of Appeals with regard to the liability of the trustee for the penalties in question.[30]

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[29] It is true that under the general language of § 6151 of the Code, the date on which the return must be filed is also the date on which the tax is required to be paid. It is only the *filing* requirement, however, that is accompanied by the sanction of a statutory penalty. Internal Revenue Code of 1954, § 6651 (a), *supra*, note 5. The sole concomitant of the failure to *pay* the taxes is the accumulation of interest on the unpaid amount. However, as we have held in Part I, *supra*, no liability for such interest attaches to the trustee in the circumstances of the present case. See also Rev. Rul. 56–158, 1956–1 Cum. Bull. 596 (penalty assessed for late filing of return in assignment for the benefit of creditors proceeding).

[30] The penalties involved in this case were incurred by the trustee after the petition for bankruptcy was filed. Therefore, in light of the considerations discussed in Part I, *supra*, the trustee is liable for interest on the penalties incurred because of his failure to file the returns. Since we have determined that the trustee is liable in any event to penalties on all of the taxes here in question, we have no occasion to pass upon the Government's alternative claim that the penalties on the withholding and cabaret taxes may be recovered as part of a trust fund under § 7501 (a) of the Internal Revenue Code, *supra*, note 22.

For the reasons stated, the judgment of the Court of Appeals for the Fifth Circuit is affirmed in part and reversed in part, and the case is remanded to the Court of Appeals for further proceedings consistent with this opinion.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 650.—October Term, 1965.

John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

[June 13, 1966.]

Mr. Justice Harlan, concurring in part and dissenting in part.

Recognizing the case to be difficult, I would affirm the Court of Appeals' decision to allow both the interest and the penality as administration expenses. On both points, I think there are fair policy arguments which can be mustered to support either result. On balance, it seems to me that the entire period starting with Chapter XI operation and carrying through the bankruptcy proceeding should be regarded as a continuum of court administraton. See especially § 378 (2) of the Bankruptcy Act, 11 U. S. C. § 778 (2) (1964 ed.). From this I think it follows that interest should not be stopped when bankruptcy succeeds the Chapter XI period, and that the court appointed trustee does fall heir to the responsibilities of the court-supervised debtor-in-possession to file returns.

SUPREME COURT OF THE UNITED STATES

No. 650.—October Term, 1965.

John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

[June 13, 1966.]

Mr. Justice White, with whom Mr. Justice Douglas and Mr. Justice Fortas join, concurring in part and dissenting in part.

I agree with all but Part II of the Court' opinion and dissent as to that part.

The issue is whether a penalty for the trustee's failure to file withholding, social security and cabaret tax returns is payable out of the assets of the estate. The Court holds that it is, even though the acts giving rise to tax liability occurred during the operation of the business by the debtor in possession prior to the trustee's assumption of office. Although the Court concedes that the trustee is not obligated to pay the tax except at the time and within the limits provided by the Bankruptcy Act, he must nevertheless undertake the sometimes difficult task of assembling all the information necessary to file the tax returns that the debtor in possession would have had to file had bankruptcy not occurred. For several reasons I do not agree.

1. The bankruptcy laws do not favor saddling an estate with penalties. Section 57j states that "Debts owing the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed . . . ," Bankruptcy Act, § 57j, as amended, 11

U. S. C. § 57 (j) (1964 ed.), and this Court has held the section applicable to a federal tax claim even where it is secured by a lien. *Simonson* v. *Granquist*, 369 U. S. 38. That case reaffirmed the "broad aim of the Act to provide for the conservation of the estates of insolvents to the end that there may be as equitable a distribution of assets as is consistent with the type of claims involved. . . . Enforcement of penalties against the estates of bankrupts, however, would serve not to punish the delinquent taxpayers, but rather their entirely innocent creditors." *Id.*, at 40–41. It is true that § 57j deals with penalties claimed against the debtor and here the penalty is claimed to arise from the trustee's alleged default. But the general policy against diluting the claims of creditors by charging penalties against the estate—very similar to the policy against allowing interest during bankruptcy which the Court rightly makes much of in this case—requires at the very least weighty and persuasive reasons for imposing upon the estate and the other creditors a penalty for the trustee's failure to file a return relating to the prebankruptcy operations of the business. If the tax return date in this case had fallen on the day before bankruptcy, § 57j would bar the penalty. I see little sense in a rule which would allow it if the return date is the day after bankruptcy.

2. The Court rests the trustee's obligation to file a return solely on § 6011 (a) of the Internal Revenue Code—"any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return . . . ." Section 6151, putting the matter the other way, imposes an obligation to pay the tax on those who who file a return. The Court says it is conceded the trustee is liable to pay the taxes incurred by the debtor in possession and therefore the trustee must file a return. But the Court obviously does not mean the trustee is "liable" to pay in the sense that he must pay claims

against the estate. For in the typical bankruptcy case where no Chapter XI proceeding has intervened—the failure of an individual proprietorship for example—the trustee is not obligated to, indeed is not authorized to, file the individual's return even though federal taxes are entitled to a Class 4 priority. I. T. 3959, 1949–1 C. B. 90. The salient fact is that the trustee's general obligation to pay claims, including tax claims, takes effect only when and if they are allowed and distribution is ordered. Any claimed liability to pay a tax at any earlier time gives way to the priority provisions of § 64a, and mere liability to pay claims is not the type of liability envisaged by § 6011 (a). If it were, the bankruptcy trustee in the ordinary proceeding not following an abortive Chapter XI arrangement could not escape the rule announced today.

Accordingly, the reliance of the Court is not on the trustee's general liability to pay claims but on the supposed "crucial fact" that the taxes here in question were incurred during proceedings under the Bankruptcy Act with the trustee being successor in interest to the debtor in possession, who also acted as an officer of the court. But had the debtor in possession continued to operate the business, his liability to file a return and to pay the taxes here in question would have have been clear under 28 U. S. C. § 960 (1964 ed.), and he could have been subjected to penalties for any default, *Boteler* v. *Ingels*, 308 U. S. 57. With respect to the trustee, however, the Court disclaims any holding that his liability arises under § 960, see *ante*, at 15, n. 28, and it seems also to disavow any implication that the trustee could be penalized for failure to pay these taxes at the time required by the Code, as distinguished from failure to file the returns, *ante*, at 16 and n. 29. Such disclaimers are entirely appropriate. For the truth of the matter is that the successor liability of the trustee who succeeds a debtor

in possession is no different from that of the trustee who succeeds the ordinary bankrupt, except that taxes accruing during the arrangement are distinguished from pre-arrangement taxes in that they are classified as administrative expenses and thus are escalated from a Class 4 to a Class 1 priority, although relegated to an inferior position within Class 1 and hence payable only if there are sufficient assets to pay prior expenses. In either instance the trustee's duty to pay is regulated by § 64a and is a general obligation to pay claims and administrative expenses not constituting the kind of liability envisaged by § 6011 (a). In sum, there is no basis in law for treating the debtor in possession and the trustee as one person, and the Court's error is in merging together two distinct periods of the estate for purposes of assessing responsibility for filing returns when it quite carefully, and correctly, separated them for purposes of determining liability to pay interest.

3. There might be some grounds for rejecting the general policy against allowing penalties against bankrupt estates if the filing of the return by the trustee performed some critical function or was at least something more than an empty formality. Section 58e of the Bankruptcy Act, 11 U. S. C. § 94 (e) (1964 ed.), expressly provides for notice to the Internal Revenue Service of the first meeting of creditors in all bankruptcy proceedings and for notices to all scheduled creditors at important stages of the proceeding. See also 26 U. S. C. § 6036 (1964 ed.) (notice of qualification of trustee). There is, therefore, little chance that the Government would not have the opportunity, for lack of notice, to file its claim as it is required to do in an ordinary case. In the matter before us now, the tax claims were clearly scheduled, the United States had ample notice and it had no trouble whatsoever in filing the statement of administrative expense to take

advantage of the priority accorded administrative items arising in the prior Chapter XI proceeding.

4. Nor is it so clear that to impose on the trustee the obligation of filing returns which the debtor in possession would have filed had he not been adjudicated a bankrupt imposes only an insubstantial burden. Trustees are normally strangers to the estate, have not participated in making or filing the schedules of assets and liabilities and, although they may be creditors, at the outset know little or nothing about the affairs of the bankrupt. They normally do not employ accountants, many times do not have attorneys and more often than not do not forthwith undertake the work and effort necessary to file a tax return. Such a filing is a serious undertaking with possible repercussions and it is not something which an officer of the court can afford lightly to discharge. If the United States claims an amount different from that scheduled, the trustee or his attorney may well have to delve into the facts and give serious consideration to the matter. But I would not require a trustee at the very outset of his duties to determine at his peril whether there are tax returns of the debtor to be filed and to undertake to file them. It would, of course, be impossible to do so on short notice; and if the return date is within a few days after the trustee's appointment, the court's rule would have untoward results.* Absent some showing of a special function to be served by the filing of the return, the wooden application of § 6011 (a) needlessly proliferates the duties of the ordinary bankruptcy trustee.

5. *Boteler* v. *Ingels*, 308 U. S. 57, does not rule this case. There the Court found an obligation on the trustee

*Extensions of time for withholding tax returns are limited to a maximum of 15 days. Mim. 6157, 1947-2 Cum. Bull. 64.

to pay license taxes on vehicles used in his own liquidating operations. Given this obligation arising out of his own activities, his failure to pay justified the imposition of a penalty and its payment from the estate. Section 57j was limited to proscribing penalties arising from the bankrupt's own defaults. That case, however, does not tell us whether the trustee was liable either to pay the tax or to file the return in the circumstances of this case. It does not follow from the trustee's obligation to pay license fees on vehicles used in his own operations that he is likewise obligated to pay a tax and file a return with respect to the debtor's prior business operations. And even if the obligation to file the return is admitted, which I do not, the fact that the return relates to prebankruptcy matters, not to the trustee's operations, brings this case much closer to those in which § 57j was clearly intended to apply.